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EXHIBITS None

COMMONWEALTH OF MASSACHUSETTS
NORFOLK, ss.

PROBATE AND FAMILY COURT
No. 87-892-D1

In the Matter Between:

THOMAS G. STEMBERG)

and)

MAUREEN SULLIVAN-STEMBERG)

BEFORE: Kopelman, J.

Norfolk Probate and
Family Court
649 High Street
Dedham, Massachusetts
Wednesday, June 26, 1991
11:05 a.m.

1 APPEARANCES:

2 White, Inker, Aronson, P.C., (by
3 Joseph H. Walsh, Esq., and W. Scott Liebert,
4 Esq.), One Washington Mall, Boston, Massachusetts
5 02108, for the defendant.

6 Barron and Stadfeld, (by Bernard A.
7 Dwork, Esq., and Enid M. Starr, Atty.), 18 Tremont
8 Street, Boston, Massachusetts 02108, for the
9 plaintiff.

10 Also Present: Murray M. Beach
11 Maureen Stemberg
12 Thomas Stemberg

13 I N D E X

| 14 | <u>Witness</u> | <u>Direct/ Redirect</u> | <u>Cross/ Recross</u> |
|----|---------------------|-----------------------------|---------------------------|
| 15 | WILLARD MITT ROMNEY | | |
| 16 | By Mr. Dwork | 2734 | |
| 17 | By Mr. Walsh | | 2856 |

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1 THE COURT: For the record this is
2 the case of plaintiff Maureen Sullivan-Stemberg
3 versus Thomas Stemberg bearing docket numbers
4 D1-87E-0056 and 87D-892-D1. In attendance today
5 are Attorneys Joseph Walsh and Scott Liebert
6 representing Mrs. Stemberg, and Attorneys Bernard
7 Dwork and Enid Starr representing Mr. Stemberg.
8 This is the 19th day of an evidentiary hearing
9 with respect to Mrs. Stemberg's motion to vacate
10 that portion of the judgment dealing with the
11 separation agreement and a complaint in equity to
12 rescind the separation agreement.

13 Mr. Dwork, you have a witness?

14 MR. DWORK: Mr. Romney. Does the
15 court mind if Mr. Romney sits?

16 THE COURT: No, he can sit.

17
18 WILLARD MITT ROMNEY, sworn.

19

20 Direct Examination:

21 Q. (By Mr. Dwork) Would you state your full
22 name and address please?

23 A. Willard Mitt Romney, and I live at 171
24 Marsh Street in Belmont, Massachusetts.

25 Q. Mitt, M I T T?

1 A. M I T T.

2 Q. And what is your occupation?

3 A. I am managing general partner of two
4 venture capital funds and chief executive officer
5 of a consulting firm.

6 Q. And the names of those funds and firms?

7 A. The name of the funds are Bain Venture
8 Capital, a California limited partnership, and
9 Bain Capital Partners, a California limited
10 partnership, both of which go by a more common
11 term of Bain Capital. And the consulting firm is
12 Bain and Company, Incorporated.

13 Q. Is one the parent organization of another,
14 or are they affiliates?

15 A. They are separate legally, and from an
16 ownership standpoint they are separate. They
17 share a common name for marketing purposes, but
18 they're separate entities.

19 THE COURT: And you're chief
20 executive officer?

21 THE WITNESS: Yes, of Bain and
22 Company.

23 THE COURT: Bain and Company?

24 THE WITNESS: Yes.

25 THE COURT: What's the difference

1 between Bain and Company and the two funds that
2 you are a general partner of?

3 THE WITNESS: Both of the funds
4 which are known as Bain Capital from a market
5 standpoint raise cash from wealthy institutions
6 and individuals, and we invest money in startup
7 companies or in acquiring companies; and we've
8 been doing that since 1985.

9 THE COURT: That's Bain Capital?

10 THE WITNESS: Yes, it's a venture
11 capital company. Bain and Company, the consulting
12 firm is a consulting firm begun in 1973, employs
13 approximately a thousand people, revenues in the
14 150 to 200 million range over the past few years,
15 offices around the world - Moscow, Tokyo, Paris,
16 London.

17 THE COURT: That's a management
18 consulting firm?

19 THE WITNESS: Exactly.

20 THE COURT: And you do both?

21 THE WITNESS: That's right. Right
22 now currently I'm doing both.

23 Q. How long has it been since you've been
24 doing both?

25 A. I have been doing both since about three

1 weeks ago.

2 Q. And prior to that which of the
3 organizations were you closely associated with?

4 A. Let me just give you a brief chronology,
5 if you will, with regards to those two
6 associations. I joined Bain and Company in March
7 of 1977 as a consulting professional, and remained
8 in the consulting business at Bain and Company
9 from March of '77 until fall of 1984.

10 In the fall of '84 I formed the
11 first of the venture capital partnerships, left
12 the consulting business and was full time employed
13 by the venture capital partnerships from the fall
14 of '84 right through until two or three weeks ago,
15 at which point I returned to the consulting
16 business as well and took on responsibility as
17 chief executive. But between 1984 and a few weeks
18 ago I had no involvement with the consulting firm.

19 Q. I guess we've started at the end and now
20 to go to the beginning - how about telling us
21 about your educational background and training?

22 A. Starting from college?

23 Q. Let's start from undergraduate school.

24 A. I attended undergraduate at Brigham Young
25 University, received an AB there. Went from

1 Brigham--

2 THE COURT: What year?

3 THE WITNESS: In 1971, and then in
4 that same year enrolled at Harvard Law School and
5 began my first year there in 1972, fall of '72. I
6 enrolled in Harvard Business School and did the
7 two schools concurrently in a joint program in the
8 '71 through '75 time period, and graduated with an
9 MBA from Harvard Business School and a JD from
10 Harvard Law School in 1975.

11 Q. And since that time would you tell us what
12 you've been doing?

13 A. Following my graduation from those
14 institutions I joined the Boston Consulting Group,
15 a consulting firm located, headquartered in
16 Boston. Was with the Boston Consulting Group
17 until March of '77, at which time I joined Bain
18 and Company, a competing consulting firm. And I
19 think I've told you the rest of the story.

20 Q. Now, let's go into the rest of the story
21 with a little more detail. Let's talk if we can
22 about your venture capital business, which is--

23 A. Call it Bain Capital.

24 Q. I think you said that it was a venture
25 capital company; is that correct?

1 A. That's correct.

2 Q. Would you tell us what kinds of businesses
3 it invests in?

4 A. We invest in two different types of
5 categories of investments. We invest in early
6 stage or startup companies with approximately half
7 of our capital, and the other half we invest in
8 currently operating businesses or we acquire
9 currently operating companies. So we participate
10 both in what is known as acquisitions or buyouts
11 as well as in startups.

12 Q. And is there something that defines
13 currently operating businesses? Does that mean it
14 is profitable, or merely that it is no longer
15 startup?

16 A. Merely that it is no longer startup. It's
17 a business that's been underway for several years,
18 and we typically acquire the entire company.

19 THE COURT: You don't acquire
20 participation in the company; you acquire the
21 whole --

22 THE WITNESS: Typically acquire the
23 whole company, although in many instances we will
24 acquire less than the entire position. We might -
25 as a matter of fact, there are several situations

1 where we've acquired a minority position in an
2 existing company. None of them have been public;
3 they're all private companies which we acquire
4 either a position in or the entire company. Just
5 as a for instance, we acquired 70 percent of the
6 common stock of an oil field equipment company,
7 but we did not acquire any of the \$150 million of
8 preferred stock that was already existing at the
9 company.

10 Q. You deal in both preferred and common
11 stock?

12 A. Yes.

13 Q. And with respect to the volume of business
14 done by your company can you help us as to the
15 total funding that you handle?

16 A. Yes. Of equity capital which we manage,
17 the total of our funds - let me just calculate in
18 my mind--

19 THE COURT: Speaking of both
20 funds?

21 THE WITNESS: Yes. Is
22 approximately \$170 million of equity capital in
23 the two funds. We have acquired or started 35
24 companies, separate companies, and the combined
25 revenues of those companies is about

1 three-and-a-half billion dollars in revenues.

2 Q. And is there some distinction - obviously,
3 there is - but what is the distinction between the
4 two venture capital companies?

5 A. Just timing. The first venture capital
6 company we raised approximately \$37 million and
7 closed that fund or organized it officially the
8 end of 1984. And we invested that money - it was
9 virtually completely vested by October of '87.
10 Our second venture capital company was formed in
11 October of '87 as we raised another block of
12 capital, roughly \$135 million, which we then are
13 investing currently.

14 Q. With respect to the acquisitions of either
15 startup companies or companies that are fully
16 operating do you deal in both preferred and common
17 stocks?

18 A. Yes, we do.

19 Q. Is it part of your job to determine or
20 agree or disagree on the prices that you're going
21 to pay with respect to both preferred and common
22 stocks?

23 A. Yes.

24 MR. WALSH: Objection, leading.

25 THE COURT: It is leading. I'll

1 let you rephrase it.

2 Q. What are your duties, if any, with respect
3 to determining the price of the preferred or
4 common stocks which your companies will pay?

5 A. In assessing which security to acquire and
6 how much to pay for securities that we might look
7 at in an existing company or a startup company we
8 have to assess what their value is and values of
9 the various rights associated with the different
10 securities. And part of my responsibility is to
11 assess the value of a whole range of securities -
12 some of them roughly known as common stock; others
13 known as preferred stock, although the preferred
14 stocks have a wide range of rights and
15 characteristics. And we assess the value
16 associated with those as we consider an investment
17 or a sale for that matter.

18 Q. Now, if we can--

19 MR. WALSH: Move to strike. He
20 said "we" all the way through. Unless he means
21 actually the "we" is him--

22 Q. I'll take care of that. Mr. Romney, when
23 you used the word "we", to whom were you
24 referring?

25 A. I was referring to each of the individuals

1 in our partnership, but each one of us performs
2 all of those functions and duties ourselves. And
3 I ultimately as the managing general partner make
4 the final conclusion with regards to each
5 investment that's made.

6 Q. If we can move over to the other Bain
7 business - and again, the name of that?

8 A. Bain and Company.

9 Q. Now, you were with them before 1987 for
10 how long?

11 A. Before 1984 I was with Bain and Company -
12 how many years - seven years.

13 Q. And what were your functions at that time?

14 A. I began as a consultant, which is the
15 entry level for a professional in the consulting
16 industry. Approximately one and a half years
17 later I became a partner of the management
18 consulting firm. The title that was associated
19 with that responsibility was a vice president, and
20 in that role I consulted for major corporations,
21 typically public companies and some private
22 companies generally in North America helping them
23 devise their strategy from a marketing,
24 manufacturing, financial standpoint. I
25 participated in mergers and acquisitions,

1 valuations of companies for purposes of
2 acquisition or divestiture.

3 Q. Then if we can distinguish between the
4 venture capital companies and the consulting, is
5 it merely a matter of whose money you're using?

6 A. I think that's fair to say, yes. In the
7 consulting company we did not invest in any of the
8 companies we were looking at. We instead were
9 being paid as an adviser by either a buyer or
10 seller or by a client. In the venture capital
11 company we're always looking with regards to
12 either an investment transaction of some kind.

13 Q. And in the company in which you have just
14 become - would it be COO or CEO?

15 A. CEO.

16 Q. Can you give us the magnitude of the
17 business done by that company?

18 A. The company has approximately 50 clients
19 around the world. The largest part of the
20 business is in North America. The company has
21 approximately 1,000 employees, revenues in the 150
22 to \$200 million range.

23 Q. Per annum?

24 A. Per annum. The employees are
25 approximately 60 percent MBAs and approximately 40

1 percent college graduates or support staff.

2 Q. And is the business of that Bain the same
3 as it was when you were a consultant and moved up
4 to vice president?

5 A. Yes, it is.

6 Q. And your present job is CEO. What are
7 your functions?

8 A. My functions are primarily the management
9 of the company, promotions, structure of the
10 company, organization, financial matters. The
11 company has a number of financial characteristics
12 that are required, some skill in restructuring the
13 financial aspect of the company, which has been
14 the a major portion of my responsibility. I have
15 actually been involved as an adviser to Bain and
16 Company for seven months now helping them in their
17 financial restructuring, and the conclusion of
18 that financial restructuring resulted in my being
19 named as chief executive officer.

20 Q. I suppose it's almost time for us to get
21 to the problem at hand. At some time did one or
22 more of the Bain organizations become involved
23 with Staples?

24 A. Yes. The first Bain capital partnership
25 was an investor in the first round of capital

1 raised for Staples.

2 Q. That would be called Round A?

3 A. I'm not sure what we called it, but it was
4 the very first round of investment which was made
5 in the company.

6 Q. And then does the name First Bain suggest
7 that's the earlier of the two of the VC companies?

8 A. That's fine, yes.

9 Q. Were you the party representing First Bain
10 who participated and made the decisions with
11 reference to these investments?

12 A. Yes, that's correct.

13 Q. Sir, would you tell us how you first
14 became acquainted with Staples and Stenberg for
15 that matter?

16 A. Felda Hardymon, a venture capital
17 businessman from another venture capital firm in
18 this area mentioned to me a gentleman named Tom
19 Stenberg had a business plan to commence an office
20 supply chain and was looking for capital to fund
21 that. I told him I didn't think it was a very
22 good idea, but I'd look at it. He sent me a copy
23 of the plan.

24 Q. He being?

25 A. Felda Hardymon.

1 THE COURT: Spell that name?

2 THE WITNESS: F E L D A, and then
3 H A R D Y M O N. Either he sent me a copy of the
4 plan or he directed me to Bob Downer at the firm
5 that was representing the - raising money for
6 Staples. I think it's called Downer and
7 Associates in Boston. But through whatever means
8 I got a copy of the plan, reviewed the plan. I
9 was impressed with the quality of the thinking and
10 the thoroughness of the plan and arranged for a
11 meeting with Tom Stemberg and his senior managers.

12 Q. Can you help us as to the approximate time
13 that you spoke to Mr. Stemberg?

14 A. Let's see, I believe the first money came
15 in in January of '86, and so we would be talking
16 then over the summer of 1985. I would have been
17 seeing him over the summer of '85 and the fall of
18 '85. Our first meetings in the summer, and then
19 through the fall and winter was evaluating whether
20 or not to invest in this startup idea.

21 Q. And in the summer of '85 do you know
22 whether Tom had already decided to do a private
23 placement sometime in early '86?

24 A. I think it was his objective to actually
25 have the placement concluded and closed before the

1 January, '86 time frame, but it took him longer to
2 raise the money and go through the process of
3 negotiating with us venture capitalists than I
4 think he would have hoped. But I believe he had
5 concluded that he was going to raise money through
6 private sources such as venture capital and/or
7 wealthy individuals, and he was anxious to get
8 that process completed.

9 Q. With reference to the Class A, call it
10 that, the first offering, do you know if there was
11 any prospectus of any type that was issued, or was
12 the investment made predicated upon the initial
13 plan?

14 A. The latter. There was not a prospectus
15 that I recall with regard to the securities
16 themselves. Instead we made our investment based
17 upon the assessment of the plan.

18 Q. Up to the time that your company actually
19 made the investment were you a member of the board
20 of directors or hold any position with Staples?

21 A. Up until the time I made the investment?

22 Q. Yes.

23 A. No, I had no association with the company
24 until we made the investment.

25 Q. Is it fair to say that an original

1 investment was 80 cents a share?

2 A. That's correct.

3 Q. And what kind of stock was it that you
4 invested in?

5 A. It was a preferred stock with a whole
6 series of characteristics of preference relative
7 to the other securities that the company would
8 have.

9 Q. And do you recall how the selling and
10 buying price of 80 cents was arrived at?

11 A. The price for the shares was a highly
12 negotiated process in determining what proportion
13 of the company should be held by those of us who
14 were putting in the capital and what proportion of
15 the company should be held by the management team
16 and Tom Stemberg in particular - he, of course,
17 wanting to keep a very large portion of the
18 condition; and we, of course, thinking we should
19 take a large portion of the company.

20 And it was through a negotiating
21 process where he spoke with many different venture
22 capitalists and looked for those who would give
23 him the biggest slice he could get, but he
24 ultimately selected the winners, meaning the four
25 of us, who were willing to give him the highest

1 price.

2 Q. Who were those four?

3 A. Ourselves, Adler and Company, Bessmere
4 Venture Partners and - let's see, I'm trying to
5 recall whether Ed Goodman came in that round from
6 Hambros America. I believe he did. Those would
7 be the four professional investors; and there are
8 other smaller investors that came in, but those
9 are the primary.

10 Q. During the first round of this private
11 capital were all of them stock common?

12 A. I don't know at that point. I believe all
13 the stock was common prior to the investment by
14 the venture capital institutional investors.

15 Q. In the process of that first offering was
16 there negotiated not only the price but also the
17 terms of the preferred and the terms of Tom's
18 employment with the company?

19 A. Highly negotiated. It was a very
20 difficult and painful process. We found Tom
21 difficult to deal with from a negotiating
22 standpoint. It took us a lot longer to reach a
23 conclusion than we had experienced in any of our
24 previous or for that matter subsequent
25 negotiations of this nature. He had a skillful

1 attorney who worked very hard to get him the very
2 best possible deal.

3 The process became so difficult
4 that Sandy Samuels who was leading the negotiation
5 and was the representative of Adler and Company
6 finally pulled out and just said, "I can't take it
7 any more, Mitt, you try." And I spent more time
8 with Tom, and ultimately we wore each other down.
9 He won some points, and we won some points.

10 MR. WALSH: Move to strike
11 everything after the initial two words "highly
12 negotiated". The rest was characterization and
13 went well beyond the scope of the question.

14 THE COURT: I suppose the answer to
15 highly negotiated would be yes. In the interest
16 of saving time with 18 days of trial, rather than
17 having him ask the next questions in describing
18 negotiations and repeat everything, I'll let it
19 stand.

20 Q. So were you the one who ultimately
21 negotiated with Tom the restrictions on his own
22 stock and his employment agreement and the buyback
23 agreements?

24 A. Yes, I was. I led that discussion for
25 some period of time. Clearly Sandy Samuels led

1 those discussions and negotiations before I did.
2 And all of the parties - Ed Goodman, Felda
3 Hardymon, Sandy Samuels and myself - had to agree
4 on our position and work with Tom. And for I
5 think the last several weeks I was the primary
6 spokesman of those negotiations from the
7 investors' standpoint.

8 Q. Incidentally, do you happen to recall if
9 the lawyer you commended so much representing Mr.
10 Stemberg was a Mr. Nichols?

11 A. Yes, Andy Nichols.

12 Q. And did you have counsel on your side?

13 A. Yes, we did. We had counsel from a firm
14 affiliated with Adler and Company; and I'm trying
15 to recall the name of the firm, but I don't recall
16 their name.

17 Q. With reference to the restrictions which
18 were imposed upon Tom's stock could you help us as
19 to what you negotiated, what it is you were trying
20 to achieve by these restrictions you were
21 obtaining?

22 A. Yes, it was very clearly our intent to
23 award Tom handsomely if the company did
24 spectacularly well. On the other hand, we did not
25 want Tom to receive any reward if he were to turn

1 out to be not an effective chief executive officer
2 of the company. So we had a wide range of issues
3 that related to his possible departure. His
4 departure voluntarily, for instance, is something
5 we did not want to have happen. And were he to
6 depart voluntarily we wanted to have the right to
7 get back his stock without having to pay him
8 anywhere near what you might consider a fair
9 market value but instead pay him a nominal value
10 to get the stock back.

11 If we were to conclude he needed to
12 be fired, we also wanted the right to do that
13 without having to pay a large penalty. So our
14 interest was in assessing what we needed to do in
15 the structure of the securities Tom would receive
16 to allow us to repurchase them or get them back
17 without having to pay him a lot in the event he
18 needed to go.

19 Q. Now, on the other side of the coin what
20 was the philosophy under which you were
21 negotiating the terms of the preferred stock?

22 A. The preferred stock it was very clear from
23 our standpoint--

24 MR. WALSH: Excuse me, could we
25 identify - is this the first class?

1 MR. DWORK: Yes.

2 A. Our desire with the preferred stock was to
3 make sure that if the company were ultimately to
4 be liquidated or harvested in some way, that the
5 first money to come out would go to us who put the
6 cash in; and we'd get our cash back plus some
7 interest on that cash. There were a number of
8 other provisions as well. We wanted to make sure
9 that we had what is known as antidilution
10 protection which is if someone subsequently came
11 in and bought shares at a lower price, that our
12 price would be converted to that lower price as
13 well; and we would get more shares.

14 We wanted to have pre-emptive
15 rights meaning that if subsequently the company
16 were to want to raise money at any price, but
17 particularly at a lower price, we would have the
18 right to buy our fair share of those lower priced
19 securities. There were a number of provisions of
20 that nature which we wanted to associate with the
21 preferred stock so that it had greater value and
22 had a greater share of the company in the event
23 that the company did not achieve the dream, so to
24 speak.

25 Q. Now, with respect to voting rights, were

1 the voting rights of the Class A different than
2 the voting rights of the common?

3 A. Yes, they were. And with regards, for
4 instance, to election of directors we had the
5 right to elect a certain number of directors. We
6 had an agreement with management and the other
7 investors as to who would have the rights to elect
8 what number of directors. We also had voting
9 rights that prevented the company from taking
10 certain actions such as raising capital without
11 our approval.

12 We could block the preferred shares
13 alone, could block various actions. We could
14 block raising capital which would in some way be
15 harmful to our round of capital. We had the right
16 to stop any merger, sale, liquidation of the
17 business, unless our class of preferred securities
18 voted in favor of such a transaction.

19 THE COURT: When you say you had
20 the right to elect a certain number of directors,
21 was that a majority of directors?

22 THE WITNESS: As I recall our first
23 agreement, it was that the preferred A holders
24 could elect three directors. The common
25 shareholders can elect three directors, and then

1 we could agree amongst ourselves on the seventh or
2 tie-breaking director who is Leo Kahn, who was a
3 very substantial director in the company. But
4 this is early history, and I'm a little fuzzy.

5 THE COURT: It's your best memory
6 Leo Kahn was the tie breaker on the board of
7 directors?

8 THE WITNESS: Yes.

9 Q. There's been some testimony at this trial
10 that at some point when the company went public -
11 I believe the point was when it could raise \$10
12 million - then all of the shares would be treated
13 equally and as common. Do you recall that
14 provision?

15 A. That's right.

16 Q. Do you have any understanding as to the
17 right of Class A stock to prevent such an IPO if
18 desired to do so even if it could achieve a \$10
19 million financing?

20 A. I do not recall specifically whether the
21 Class A stock would prevent a public offering.
22 That I believe - well, I don't want to speculate,
23 but I will anyway - that will frustrate--

24 MR. WALSH: Objection.

25 THE WITNESS: I won't speculate

1 then.

2 THE COURT: You can't speculate,
3 guess or surmise. You can testify from your best
4 memory.

5 A. My best memory with regards to this
6 provision was that there was a provision that the
7 preferred stock could be forced into becoming
8 common stock if there were a public offering of
9 \$10 million or more.

10 THE COURT: The preferred stock
11 would be automatically converted to common stock
12 if an IPO raised \$10 million or more.

13 THE WITNESS: That's right, and I
14 believe it was a certain price, but I don't
15 recall.

16 Q. If I suggest \$5 a share, does that refresh
17 your memory?

18 A. It doesn't.

19 Q. Do you have a memory whether the A class
20 could, in fact, thwart the common's desire to have
21 that occur?

22 A. I don't. Let me say that in a different
23 way; which is, I don't recall. I have a memory
24 that does not include in it that the common could
25 prevent - excuse me, the preferred could prevent

1 the common from doing that. Rather my memory is
2 that the management and common shareholders could
3 proceed with an IPO, and the preferred could not
4 stop that from happening.

5 THE COURT: Provided the \$10
6 million was raised, provided a certain price was
7 achieved - both of those requirements apparently
8 were required?

9 THE WITNESS: That's right.

10 THE COURT: If the \$10 million or
11 more stock was floated to get \$10 million, would
12 it dilute your shares you needed, both a dollar
13 figure on your shares plus \$10 million in order to
14 be powerless to stop an IPO?

15 THE WITNESS: That's correct.

16 Q. Sir, after Bain made the investment in
17 Staples did you become a director of Staples?

18 A. Yes, I did.

19 Q. And could you give us the dates during
20 which you were or have been a director of Staples?

21 A. From the closing of the financial
22 investment, which would have been in January of
23 '86, until the present time I have been a member
24 of the board of the company.

25 Q. And as a member of the board at Staples

1 have you from time to time participated in votes
2 prior to the IPO authorizing the issuance of
3 options on common stock?

4 A. Yes.

5 Q. And does Bain itself buy common stock?

6 A. Yes, Bain and Company - excuse me, Bain
7 Capital, the venture capital partnership, does buy
8 common stock. It has not bought common stock in
9 Staples, but it does buy common stock.

10 Q. All right. You said they invested in two
11 kinds of investments - startups and companies that
12 are underway. With respect to the startup
13 companies generally does Bain invest in common?

14 A. We have invested in both common and in
15 preferred stock, although in a startup it is far
16 more typical for us to invest in preferred stock
17 than in common stock.

18 Q. With respect to private companies in which
19 a venture capital investment is being made, is
20 there generally some recognized difference in the
21 value between preferred and common?

22 MR. WALSH: Objection, it's
23 leading.

24 THE COURT: I'll let him have it.
25 There's no other way to ask that question, whether

1 there's a difference between the value of the two
2 stocks. It's not leading to the extent that the
3 answer could be yes or could be no. The question
4 is not suggesting the answer. You can have it.

5 A. Yes, there is a difference in the
6 touchstone or the initial assessed value of
7 preferred versus common. In the companies we're
8 looking at the value of options, sometimes the
9 range, might be a ten to one difference in
10 values. Sometimes it's as high as a 100 to one
11 difference in value. That depends in part on the
12 success of the business.

13 Clearly, if you were one day away
14 from a public offering, the difference or the
15 preferred would - were it to get converted into
16 common, those numbers wouldn't make sense
17 anymore. But in the early stages most firms think
18 of a ten to one kind of range and some a higher
19 range between preferred and common stock.

20 Q. Just from ten to one, meaning if you were
21 going to pay ten for preferred, you'd pay one for
22 common?

23 A. That's right.

24 Q. We'll get back to that. When a venture
25 capitalist such as you makes an investment in a

1 Staples, if you will, is there some search to find
2 out what might be an exit strategy for getting out
3 of the investment?

4 A. There's always - at least in the case of
5 our fund, and I'm sure most funds - there's always
6 an assessment, If this works, how will we realize
7 our investment? How will we get out?

8 Q. What are the various ways you might
9 anticipate getting out?

10 A. Sale of the company or public offering of
11 the stock are the two most common of the ways
12 you'd like to get out. The most common of the
13 ways you do get out include liquidation and sale
14 of the company in a disadvantageous way.

15 Q. And that would be because of failure of
16 the company to meet its plan?

17 A. That would be the largest reason. A very
18 high proportion of startup companies invested in
19 do not achieve their objectives for a variety of
20 reasons, and as a result an IPO or - excuse me, a
21 public offering of stock is not feasible or a sale
22 of the company is also not feasible. And so it is
23 either wound down and liquidated in some way,
24 broken apart with pieces being sold and
25 liquidated, or perhaps sold at a disadvantageous

1 price.

2 Q. And what relationship does that have to do
3 with the ten to one for preferred to common?

4 A. The reason that one values a preferred
5 stock as highly as one does relative to common
6 stock in an early stage or startup company is that
7 the probability of a successful outcome is not
8 extremely high; and therefore, one has a good deal
9 of experience in selling a company or harvesting
10 it for less than the ultimate you might get if you
11 were highly successful and could go public. And
12 in a situation where you might be selling a
13 company for less than your dreams, the preferred
14 stock gets all of its money back first.

15 And so in settings of that nature
16 the value of that preferred stock is very high,
17 and the common stock winds up getting nothing or
18 next to nothing. Given that experience in startup
19 companies one tends to value the preferred much
20 more highly than the common.

21 Q. Well, when you're looking for an exit
22 strategy or for that matter when you're looking
23 for an investment, are you looking for a
24 particular rate of return?

25 A. Yes, the rates of return have changed over

1 the past several years given the change in the
2 financial markets. But the rates of return for
3 early stage companies that most venture capital
4 funds would target, and that we in particular
5 target, is a ten to one return in five years.
6 That's the hurdle, if you will, and that happens
7 to calculate to a 58.5 percent internal rate of
8 return. That's the target level.

9 Q. That's for a startup company?

10 A. That's for a startup company.

11 Q. And how would you describe Staples at the
12 time that the A stock was issued as to whether it
13 was a startup or mezzanine or some other?

14 A. It was a startup company.

15 Q. And what's the basis for your saying it
16 was a startup company?

17 A. It had no sales, no assets, other than a
18 plan and management that were willing to get
19 started.

20 Q. So you were looking for 58 percent return?

21 A. That's correct.

22 Q. And you say that's consistent with what
23 other VCs would be looking for?

24 A. That's right. Some might be looking for
25 40 percent, some 50, but most are looking -

1 they're basically saying, If this company is able
2 to achieve its dream, if everything works the way
3 we hope it will work and we do the best in our
4 analysis to make sure that happens, will we reach
5 our goals in five years?

6 Q. If one gets into the mezzanine stage, if
7 you will - and would you give us a description of
8 what you'd call a mezzanine company?

9 A. A mezzanine company or a mezzanine stage
10 of investment is when a company has gone beyond
11 having no assets and having no business, but it
12 now has assets. It has revenues. It is typically
13 still unprofitable, although it may be profitable,
14 and where it is looking for additional capital for
15 growth or expansion or just to cover its losses if
16 it's still unprofitable.

17 Q. Going back to 1987 - first thing, let me
18 ask - when you gave a return of 58 percent on a
19 startup company, was that applicable in the '86,
20 1987 period?

21 A. Yes, it was.

22 Q. And going back to the same period of '87,
23 let us say, what would be the anticipated return
24 for you or for another venture capitalist with
25 respect to a mezzanine company?

1 A. The rates of return for a mezzanine
2 investment by parties who invest in mezzanine
3 rounds of financing would be lower than that,
4 would probably be in the 40 to 45 percent rate of
5 return. Although our rate of return, we would
6 hope to still get the 58 percent, but that's
7 typical. Far more typical is an investor looking
8 in the 40s type of rate of return for that level,
9 for that stage of investment.

10 Q. Have you made any study as to what the
11 actual rate of return is for the average venture
12 capitalists?

13 A. There are studies provided by various
14 sources as to the rate of returns on venture
15 capital funds depending on the year of their
16 commencement. Funds started at the same period of
17 our fund, which was the '84, '85 time period, have
18 had rates of return in the single digit to low
19 double digit levels, meaning the eight, nine, ten,
20 11, 12 percent rate of return has been the average
21 for funds started during than period.

22 Q. Those are companies who were looking for
23 58 and 40 percent returns?

24 A. Yes, we occasionally miss.

25 MR. WALSH: Objection. He says

1 there's been a study. There's been no testimony
2 he knows what companies were included.

3 THE COURT: How is it relevant,
4 what another company's rate of return is? How is
5 it relevant to this litigation?

6 MR. DWORK: It shows the risk
7 that's involved, that one may be looking for 58 or
8 40 percent but they average out to ten or 11
9 percent when they're through because of failures.
10 That's why I believe it's relevant.

11 THE COURT: Has he canvassed - I
12 don't know how many companies he's looked at.

13 MR. DWORK: He's an expert. He can
14 rely on articles and studies of others as a basis
15 of his opinion. He doesn't have to do it himself.

16 THE COURT: If he can demonstrate
17 some knowledge of canvassing of funds across the
18 country and can talk about of the capital venture
19 firms what is the actual rate of return realized
20 for a time period - assuming he has some knowledge
21 of that.

22 Q. Let me ask you this, sir - do you
23 continually study the field of venture capitalism?

24 A. Yes.

25 Q. Do you belong to any organizations in that

1 field?

2 A. Yes, we belong to the New England Venture
3 Capital Association. In the past we have belonged
4 to the National Venture Capital Association, and
5 we do meet in conference with SIGNA. SIGNA is a
6 large insurance company which has invested in 40
7 to 50 venture capital funds, and we have met in
8 conference with them to determine the average rate
9 of return of venture capital investments made by
10 them in the 40 to 50 venture capitalist funds in
11 which they have investments.

12 Q. Are there publications of cases in this
13 field?

14 A. Yes, there are a wide range of
15 publications - Venture Economics, a private
16 professional magazine, as well as Venture, Inc.,
17 as well as other magazines that study and follow
18 the venture capital industry.

19 Q. Do you read these publications?

20 A. Yes.

21 Q. And do you find them helpful in acquiring
22 your own expertise in this field?

23 A. They are helpful in helping us understand
24 the success or lack of success of our fellow
25 venture capital investors in various investments

1 they might make.

2 Q. And sir, do the publications, in fact,
3 print studies that are made as to the success and
4 failures of venture capitalism?

5 A. Both private and public surveys made of a
6 wide range of venture funds assessing the rate of
7 success of those different funds. And so studies
8 of that nature are made, and I have reviewed them.

9 Q. And sir, I'll again ask you - for a
10 company that started at the time that your company
11 started as a venture capitalist, what has been the
12 overall average rate of return?

13 A. The surveys do not conclude with all
14 exactly the same final number because the surveys
15 include different numbers of venture capitalist
16 companies, but the surveys published both
17 privately and publicly show returns as low as
18 single digits, eight, nine, ten percent, and
19 others that show returns in the low teens.

20 Q. And can you explain why a company that
21 looks for a 58 or 40 percent return ends up with a
22 return in the single or low double digits?

23 A. The reason for that is that a number of
24 the companies we invest in with the expectation of
25 receiving ten times our money in five years, a

1 number of those companies achieve far less than
2 that, and several of the companies are typically
3 totally unsuccessful and must be closed at a total
4 loss.

5 Q. Sir, we were talking about an IPO date.
6 As a venture capitalist do you have some criteria
7 for determining when a potential IPO date is going
8 to exist for a private company of the type of
9 Staples, let's say?

10 A. For a venture capitalist such as ourselves
11 when a company shows a record of profitability is
12 the time when you automatically consider that you
13 have an opportunity to be a public company. In
14 most circumstances, other than in very high tech
15 companies, general tech-type companies, a company
16 has to be profitable to go public at an attractive
17 price. That is not always the case, but that's
18 the rule of thumb. So we look at a time when a
19 company will be profitable; and then we hold the
20 assumption that if the public market is receptive
21 at that point to new issues of stock, then that
22 would be a time when we could go public.

23 Q. And without a three-hour lecture on the
24 marketplace, what does market receptability mean?

25 A. Well, there are times when the

1 institutions and individuals who typically
2 purchase stocks are interested in acquiring
3 stocks; and there are high multiples, price
4 earnings multiples, on the market. And there are
5 other times when those buyers are not interested
6 in buying stocks. For instance, in the period
7 following October 19, '87, with the huge crash
8 there was a dearth of public offerings because
9 people were fearful. They were concerned about
10 harvesting their investments, not adding to them.
11 And therefore, it is referred to as the window
12 being closed. The window access to the public
13 market was not open; and therefore, very few
14 companies were able to go public successfully.
15 Of course, one can only go public
16 at some price; but there's a price at which the
17 valuation is attractive and a company would want
18 to go public. And there are good times and bad
19 times based on the receptivity of buyers to public
20 stocks.

21 THE COURT: This is October of
22 '87?

23 THE WITNESS: Yes.

24 THE COURT: So-called Black
25 October?

1 THE WITNESS: Exactly.

2 Q. Now, you've dealt, I gather, with a lot of
3 entrepreneurs who were trying to sell you on the
4 future prospects of their company; is that
5 correct?

6 A. That's correct.

7 Q. Do you find that with some frequency
8 they'll propound that there's going to be an IPO
9 at some particular time?

10 A. I think virtually every one of the startup
11 companies that we consider for investment has as
12 part of its business plan a period when the
13 company will become profitable, and therefore,
14 will be taken public.

15 Q. What has been your experience with respect
16 to the accuracy of those projections?

17 A. They are inaccurate by a very wide
18 margin. I'd say of 100 companies or business
19 plans that come to the door of venture - I'll
20 refer to myself - of 100 business plans that come
21 to our door, we will probably invest in one or
22 less. And of the one or less that we invest in,
23 I'd say maybe half at the most are able to become
24 public companies.

25 Q. And of those who become public companies

1 how many do so within the time parameters that
2 they project?

3 A. I'm going to have to refer to our own
4 experience, and it has been rare that we have been
5 able to meet our time projections. For perhaps
6 understandable reasons we never anticipate all the
7 problems that can occur. The needs of companies
8 for money almost always exceed what our plans
9 would suggest, and as a result the delay in being
10 able to go public and the amount of capital needed
11 to get the company to a point where it can go
12 public exceeds our expectations most typically.

13 Q. Let's talk about Staples then. You talked
14 about problems that arise after the business
15 plan. After you became a member of the board of
16 directors, talking about Tom Stemberg personally,
17 were there problems which arose which caused some
18 amount of confrontation or at least discussion
19 between the board and Tom?

20 A. Yes.

21 Q. Would you tell us those that you remember
22 and what you remember about it?

23 A. Well--

24 MR. WALSH: Could we have the time
25 period?

1 THE COURT: That would be useful.
2 Before you get into that let me ask you this
3 question - this has come up, but of I don't know
4 if there's been a definitive answer. Did the
5 business plan presumably target a date for
6 profitability?

7 THE WITNESS: Yes.

8 THE COURT: Did it also have a
9 mention of an IPO date, or was that just inferred
10 from the profitability, if you recall?

11 THE WITNESS: It was inferred from
12 the profitability.

13 THE COURT: An IPO date wasn't
14 discussed or mentioned in the business plan, to
15 the best of your knowledge?

16 THE WITNESS: To the best of my
17 knowledge, no.

18 THE COURT: You infer from a
19 deadline for profitability or target date of
20 profitability a potential IPO date assuming the
21 market is receptive; is that what you testified
22 to?

23 THE WITNESS: That's right. If
24 someone shows me a plan which in year four a
25 company is making \$3 million, I have a high degree

1 of confidence in year four we can go public if we
2 want to. And then it's a question of how
3 receptive the market is.

4 THE COURT: Now you're being asked
5 about problems between the board and Mr. Stemberg.

6 Q. As you tell us about them if you can pin
7 it to a time, it would be helpful.

8 A. The first store was opened in Woburn in
9 May or June of 1986, as I recall that time period,
10 and there were no problems. No significant
11 problems associated with the board prior to that
12 time period. In the months that followed we
13 opened another store. Did I say Woburn? The
14 first store was opened in Brighton in May or
15 June. And I think in the fall, perhaps September,
16 October, we opened our second store in Woburn.

17 And Woburn was not performing as
18 well as we had anticipated. We had a sales plan
19 which showed Woburn starting at a certain level
20 and rising; and it did not start as high as we
21 hoped, and it did not rise as fast as we hoped.
22 Our third store was Providence, and it likewise
23 fell far behind our expectations. So the first
24 area of concern was whether management or Tom in
25 particular was selecting the right sites with

1 sufficient care and whether we needed a different
2 process for selecting sites.

3 A second area of concern was the
4 operational problems in the store, and this is in
5 the beginning of 1987, first quarter of '87.
6 There were some members of my board, of the
7 Staples board led by myself, who were concerned
8 that we had extensive stock-outs of merchandise.
9 But more importantly, I was concerned with the
10 length of time it took customers to go through the
11 check-out line. And I consistently urged Tom and
12 was very critical about the lack of progress we
13 were making of getting customers through our
14 check-out lines. And I heard numerous complaints
15 from friends that I referred to Staples that they
16 found Staples a hard place to shop, and they found
17 our employees to be surly. And so--

18 THE COURT: You mean to say as a
19 member of the board of directors you delegated
20 somebody to go down and time the length of time it
21 took to get out of the check-out line?

22 THE WITNESS: I didn't have to
23 delegate. I was shopping there myself and found
24 it a frustrating experience.

25 THE COURT: You're talking about

1 personal experience.

2 THE WITNESS: Yes.

3 THE COURT: Does that go for surly
4 employees as well?

5 MR. DWORK: They hired legal
6 secretaries.

7 THE WITNESS: I told a friend to go
8 there, and he came down and said, "Prices are
9 terrific, but I won't shop there anymore. The
10 people are awful and people couldn't get through
11 check-out." We couldn't process credit cards. It
12 took ages there was operational problems in
13 running the stores, and we had expected that Tom's
14 experience as retailer would mean that all that
15 would go away; we'd never have problems like
16 that. And we were very critical of those problems
17 - so both the operational problems in the store
18 itself as well as the lack of sales in the number
19 two and three stores, which were Woburn and
20 Providence respectively.

21 The pressure that was raised became
22 severe enough that Tom ultimately hired a vice
23 president of operations, whose name escapes me,
24 and he came in and--

25 Q. If I suggest Massua [sic]--

1 A. Yes, John Massua was the vice president of
2 operations. I interviewed him before he was
3 hired. I told Tom I was not impressed with his
4 personal demeanor and skills and apparent
5 understanding of the business. But Tom was
6 convinced that he had done well in other settings,
7 proceeded to hire him; and he set about to try to
8 fix the operational problems.

9 By the fall of 1987 my concern
10 continued to relate to the lack of sales growth in
11 the stores that we had opened. At this point we
12 had opened another store, I believe, in the summer
13 of '87 in Port Chester, New York - could have been
14 the fall of '87, but it did not ramp up as quickly
15 as we had anticipated either. So we were
16 concerned about the lack of sales in the current
17 stores.

18 Around this time, probably fall of
19 '87, Tom and Leo Kahn, the chairman of the board
20 at that point, became convinced that we needed to
21 have a distribution center, build a warehouse, if
22 you will. And that was very disturbing to some
23 members of the board particularly Sandy Samuels,
24 the representative of Adler, was adamant that that
25 was not a good idea. Mr. Adler and Mr. Samuels

1 were also upset that we were growing as slowly as
2 we were. They thought we should have been opening
3 stores faster, and that we should not have a
4 warehouse that would slow us down.

5 They were so convinced of that they
6 invested through family funds - or Mr. Adler
7 invested through his family's funds in a
8 competitor of Staples, a company called Office
9 Depot located in Florida. They were angry enough
10 at Tom during this time period that they called
11 Mr. Adler, reported to Sandy, and Sandy said at
12 our board meeting that Mr. Adler was saying why
13 don't we just bring a bunch of our stores from
14 Florida up here, put them in Manhattan, and we'll
15 take over the east coast and knock Staples out.

16 It was very upsetting to us who
17 were investors in Staples, but clearly Mr. Adler
18 and Mr. Samuels were disappointed with the rate at
19 which we were opening stores and the success of
20 those stores in sales volume. And they were not
21 pleased with the decision to consider a warehouse
22 or distribution center.

23 In response to that concern Tom
24 hired an outside consultant to evaluate the cost
25 benefit of a distribution center. And the

1 conclusion of that study - and it was an
2 accounting firm that did the study, I believe -
3 was that it did make sense, and the board agreed
4 to go ahead with that distribution center despite
5 the objection of Sandy Samuels.

6 Q. Was that a continuing objection after the
7 report?

8 A. Yes.

9 THE COURT: When you say Adler,
10 you're referring to Fred Adler?

11 THE WITNESS: Right.

12 THE COURT: You mean to say his
13 company was one of the four corporate investors in
14 this first round of financing?

15 THE WITNESS: Right.

16 THE COURT: He went ahead and then
17 apparently invested in a competitor?

18 THE WITNESS: Yes.

19 THE COURT: Didn't that create a
20 conflict of interest for him to remain on the
21 board, for a representative to remain on the
22 board?

23 THE WITNESS: It did.

24 THE COURT: How was that dealt
25 with?

1 THE WITNESS: As a board we were
2 very upset. I went down and met with Mr. Adler in
3 New York and had tried to convince him this was a
4 bad idea. He was not friendly in the meeting and
5 called me various names and basically said, It's
6 none of your business; we'll do what we want to
7 do. And he was not entirely pleased with the
8 direction of the company with the rate of its
9 growth and with how it was proceeding; and
10 therefore, he went ahead and did what he wanted to
11 do.

12 And the rest of the board was very
13 upset about that. There became a campaign inside
14 the board to get Sandy Samuels off the board. I
15 don't recall when we were finally successful in
16 doing that. It was a painful process with threats
17 of legal action, etc., that were made by Mr.
18 Adler; but ultimately, we were able to peacefully
19 separate his representation from the board.

20 THE COURT: Were there any
21 restrictions in the last A stock, any restrictions
22 upon the investors from investing with a
23 competitor?

24 THE WITNESS: There were not.
25 There will be the next time we do this, but there

1 were not at that time.

2 THE COURT: Go ahead.

3 Q. I think you were telling us about the
4 continuing problems?

5 A. We had a series of meetings that related
6 to the operational difficulties at the company,
7 the fact that our sales were less.

8 MR. WALSH: Could we establish a
9 date again? I don't know if we're still in the
10 fall.

11 A. Fall of '87. Sandy Samuels who was still
12 at this stage a very active member of the board,
13 myself and Leo Kahn, which formed the executive
14 committee at the time, met with Tom and the
15 management team sometime in the fall of '87 to
16 consider the operational and other shortfalls of
17 the company. Tom had, as I recall, Dave Massua
18 make a presentation as to what he was doing to
19 improve the check-out, the processing of credit
20 cards, the stocking of the shelves, the
21 merchandising, which is the purchasing of the
22 right products. I thought that presentation by
23 Mr. Massua was very inadequate and unprofessional,
24 and made me very concerned that he did not have
25 the capability to do the job.

1 THE COURT: Is the correct name
2 John Massua? Would counsel agree--

3 MR. DWORK: M A S S U A.

4 THE COURT: And the first name,
5 John?

6 THE WITNESS: John.

7 MR. WALSH: I heard the testimony
8 through Massua of this most recent time. He said
9 David Massua, that's the witness that Mr. Dwork
10 intended to call, and we had a discussion and the
11 motion hearing about--

12 THE WITNESS: If I said David, I
13 did not mean to say David - John Massua.

14 THE COURT: That was the individual
15 you were dissatisfied with?

16 THE WITNESS: Yes. I believe his
17 title was vice president of Staples or head of
18 operations for Staples. Dave Massua, who I
19 understand is a head hunter, an executive search
20 consultant - but I don't believe they're related
21 in any way other than my slip of the tongue.

22 John Massua made a presentation on
23 the operations of the store which I found lacked a
24 good deal of credibility, was not pleased. And
25 then Tod Cressna [sic] made a presentation on the

1 marketing initiatives the company was talking
2 about. I thought the presentation was
3 acceptable. Tom played a very active role in
4 those discussions, and Sandy Samuels was very
5 upset with that presentation, thought that we did
6 not have our act together from a marketing
7 standpoint.

8 At this stage our advertisements
9 were antiseptic and not very effective relative to
10 our competitor, Office Depot, which had a far more
11 bold and aggressive advertising program, which
12 from our analysis were doing better - stores
13 opening faster and higher sales. We had data,
14 competitive analysis - when I say we had data,
15 because we had a member of our board who had a
16 sister investment in that company. So we knew
17 they were doing better.

18 Sandy was concerned about the
19 presentations and the lack of progress there, as I
20 was, and Leo shared that same concern. And in or
21 around that time we began talking to Tom - and I'm
22 not sure whether it was before or just after -
23 about looking for a chief operating officer, an
24 experienced retailer, that could manage the
25 business on a detailed basis to come into the

1 company and perform that role. That was another
2 area of conflict.

3 At this time Tom resisted bringing
4 in a person of that nature. It was our
5 guesstimate that Tom was resisting because he
6 thought he might be replaced by such an
7 individual; that was the interest that we had in
8 talking with a person of that nature. And the
9 truth of the matter is we were looking for someone
10 who could manage the operations of the business;
11 but we also recognized that if Tom went off the
12 reservation, we needed someone who could replace
13 him. So we insisted on looking for someone who
14 could fill that position.

15 Q. And ultimately, did Tom agree and --

16 A. Ultimately Tom accepted that conclusion,
17 and I think became very convinced it was a great
18 idea. And we considered a number of candidates
19 over a number of months. I don't know when Henry
20 Nessella, who is the current president and chief
21 operating officer of the company - I don't recall
22 the specific time he joined the company - but that
23 was the culmination of that process which took
24 many, many months as we interviewed a wide range
25 of candidates for that position.

1 Q. Have you finished your answer as to the
2 problems, or were there more?

3 A. There were problems of - interpersonal
4 problems on occasion, style problems, that
5 occurred at the board meetings; but I don't
6 believe those are substantial or merit going into.

7 (Recessed.)

8 THE COURT: Mr. Dwork.

9 Q. Sir, I think you mentioned about the
10 problems in September of '87. Was that about the
11 same time that there were discussions of a Class C
12 and Class D offering?

13 A. A Class C offering was discussed in the
14 time frame of September of '87.

15 Q. Did Bain participate in investing in that
16 round?

17 A. Yes.

18 Q. And did it participate to the full extent
19 that it was permitted to do so, or did it invest
20 something less?

21 A. We invested somewhat less than our full
22 right to invest.

23 Q. Can you help us as to how the price of
24 \$2.90 a share was arrived at?

25 A. Yes. You basically have the same process

1 any time you have a buyer and a seller. The
2 seller was Tom and the management team speaking
3 for the company, and the buyers were the
4 individual potential investors. And Tom the
5 seller wanted the price to be as high as he
6 possibly could have it, and we the buyers wanted
7 the price as low as we could possibly get it.
8 And so there was a discussion as to what price
9 would be able to raise the money that the company
10 needed at that point.

11 And so there was a negotiation, Tom
12 speaking - I don't want to speak for him - but
13 speaking not with just the investors around the
14 table, but in speaking with other potential
15 investors to see what they'd be willing to buy.
16 And speaking for me, for instance, and seeing what
17 we needed - and presented this to the board as to
18 how much various investors would be willing to buy
19 it at what prices. And we knew what we needed,
20 and we arrived at a price that would clear the
21 market or a price at which we could get sufficient
22 capital on the market.

23 Those of us on the board who are
24 also investors have a complicated role. As board
25 members we want to get as high a price as possible

1 for the company, and as investors we want it low.
2 Tom's is a much more pure position in that
3 regard. He just wants to see the price as high as
4 possible, and I'm sure he relies somewhat on the
5 fiduciary duty of the board members to see we get
6 that, but also looks outside the board.

7 MR. WALSH: Move to strike what he
8 assumes Mr. Stemberg--

9 THE COURT: What he assumes can go
10 out. The rest can stay. You really have a
11 conflicting position on the board.

12 THE WITNESS: That's right.

13 THE COURT: You want the company to
14 get enough capital to succeed; on the other hand,
15 you don't want to have to pay top dollar for your
16 additional investment.

17 THE WITNESS: That's right. There
18 is that concern. At the same time, because we are
19 very large investors in the early rounds, the very
20 beginning rounds of capital, we like to see people
21 coming in later at as high a price as possible.
22 So in this particular circumstance my personal
23 interests aligned very closely with the company's
24 and Tom's in that I wanted to see the price as
25 high as possible. I knew I was going to be taking

1 a relatively small portion of it because I thought
2 that price was too high, and I'm not willing to
3 invest at this price, and so let's get the price--

4 THE COURT: You paid 80 cents on
5 the first round; is that right?

6 THE WITNESS: That's right.

7 THE COURT: How much capital was
8 invested in that first round?

9 THE WITNESS: About four and a half
10 million dollars total, of which we invested
11 approximately one and a half million in the first
12 round.

13 THE COURT: 1.5 million. And the
14 second round you paid how much a share?

15 THE WITNESS: B was \$2.10 a share.
16 I believe that's the second round.

17 THE COURT: And how much capital
18 did Bain come in with, total committed, and what
19 was --

20 THE WITNESS: I'm not sufficiently
21 prepared to tell you how much was committed for
22 each round. I can be prepared tomorrow to do that
23 by looking at our records.

24 THE COURT: If you could at least
25 look up to determine what Bain committed. And the

1 third round was the \$2.90?

2 THE WITNESS: Both the subsequent
3 rounds, second and third, we invested
4 significantly less than we did in the first round.

5 THE COURT: If you could perhaps
6 bring those figures tomorrow--

7 THE WITNESS: Fine.

8 Q. That was both B and C you invested less?

9 A. Yes.

10 Q. You may have answered the question, but
11 I'll ask anyway - why did you invest less than the
12 total amount that was offered?

13 A. We believed that the valuation of the
14 securities was higher than we thought was
15 appropriate for that stage of the company.

16 THE COURT: The price was too
17 high?

18 THE WITNESS: Yes, we were
19 obviously proved wrong ultimately, but the price
20 we thought was high at that stage given the
21 company's performance.

22 Q. If that was the case, why did you invest
23 at all in B or C?

24 A. Not to invest - if a first round lead
25 investor does not invest in subsequent rounds of

1 capital, that could make it very hard to attract
2 anyone else. And it would be a real kick in the
3 shins to a company if the early investors do not
4 continue to invest in each round. There is an
5 obligation to support a company you invest in and
6 keep investing in subsequent rounds. We felt that
7 obligation. Although we did not invest as much as
8 we could have invested, we invested to show the
9 other investors we were inviting in at that time
10 that we backed the company and continued to.

11 THE COURT: Is that an ethical
12 obligation? When you say there's no legal
13 obligation--

14 THE WITNESS: No legal obligation,
15 not an ethical - it is a good business practice if
16 you're selected as a lead investor to continue to
17 support the company by investing in subsequent
18 rounds of financing as a way of showing other
19 potential investors that you're convinced that
20 it's still a good company. Even though you may be
21 convinced the price is high, you still think it's
22 a good company.

23 THE COURT: Your concern is that
24 subsequent investors or providers of capital will
25 infer from your reluctance to invest some kind of

1 a curse or worse state scenario?

2 THE WITNESS: We come in and invest
3 in other companies with similar situations as B
4 and C rounds. If the first round lead investor
5 was not putting in any more money, we would
6 automatically not proceed. And there are many
7 funds like ourselves - if someone who has been
8 there watching the company doesn't want to put in
9 any more money, we should stay away. We thought
10 the price was a little high and decided to invest,
11 but not to invest as full amount as we had the
12 rights to invest. We could have invested a good
13 deal more than we did.

14 THE COURT: Are you able to
15 determine what percentage of the investment you
16 made; that is, what percentage of the actual
17 investment versus your right to invest? Did you
18 invest half of what you had a right to?

19 THE WITNESS: I can calculate that
20 and provide that to you.

21 THE COURT: Tomorrow?

22 THE WITNESS: Yes.

23 Q. Sir, in addition to supporting the company
24 by second and third round contributions, does it
25 also protect your A investment?

1 A. Yes, certainly. If we know the company
2 needs to get additional capital, we need to make
3 an investment to entice other people to follow the
4 capital in and protect our investment as well.
5 And in this case we believed Staples was a
6 successful company and believed that it would be a
7 good company. We just didn't believe that it
8 would do as well as it was projecting for itself
9 on the time period it was projecting for itself.

10 Q. Just before we go into the valuations,
11 sir, of the various classes of stock I'd like to
12 ask you about this term pre-money and post-money
13 valuations. Are you familiar with the terms?

14 A. Yes.

15 Q. And just to recapitulate as to what it is,
16 why don't you explain it? It will be easier than
17 if I do.

18 A. Let's see, those are venture capital
19 terms. They're used by people in our business.
20 They are not - they're actually not valuation. We
21 talk about pre-money valuation and post-money
22 valuation. They are by no means a valuation of
23 the company. They are a shorthand which we use to
24 describe to one another or to ourselves what
25 percentage of the company we got for how much

1 money in the hoped for circumstance down the road
2 if the company were all sold, all shares were sold
3 at the price we had just paid.

4 So it is - for instance, if someone
5 wants to start a company and they say to me,
6 'Mitt, if you'll put in a million dollars, we can
7 split this company 50/50. You put in a million
8 dollars, and I'll own 50 percent, and you'll own'
9 - so the pre-money valuation was a million
10 dollars. That's what his value was without my
11 money. If he didn't have to put up anything, then
12 his idea is going to be valued at a million
13 dollars.

14 The post-money valuation is his
15 million in value, my million in capital, or \$2
16 million. So the post-money valuation of my little
17 hypothetical company is \$2 million. On the other
18 hand, if you sold that company that day, it only
19 has a million dollars in cash; you only get a
20 million dollars for it. The guy that put the
21 million in, if he had preferred stock, we'd get
22 the million dollars back. And that's what would
23 happen.

24 When we talk about a \$12 million
25 post-money valuation, we're talking about a

1 circumstance which is hypothetical, which is if
2 the company were to be sold where all classes of
3 security got the same price. This is how much the
4 company would be receiving, and it's a way of
5 assessing how much I got for my shares. In the
6 case of my million dollar hypothetical, a \$2
7 million post-money valuation says that my one
8 million got 50 percent.

9 Q. Now, sir, at my request or at Tom's
10 request through me did you at one point try to
11 attempt to evaluate the preferred stocks, the
12 Class D preferred, the common stock and Tom's
13 common stock for the period September, 1987
14 through February, 1988?

15 A. Yes, I did.

16 Q. And do you happen to recall when you were
17 first asked to do that?

18 A. Let's see, it was associated with this
19 proceeding, so it would have been in May or June
20 of 1990 would be the first time I was asked to
21 look at that.

22 Q. And sir, did you arrive at some values?

23 A. Yes.

24 Q. With respect to the values that you
25 determined did you start at some base figure?

1 A. Yes. In assessing the valuation I
2 considered what was the appropriate methodology
3 for assessing valuation. If a company is private
4 and there have been no transactions in its
5 securities, then one must go to a comparable type
6 of valuation methodology, which is to look for
7 other companies and see what they're worth and by
8 inference determine what the worth is of the
9 specific company you're looking at.

10 In this case that methodology
11 doesn't make sense in my opinion. Instead because
12 there had been transactions between sellers and
13 buyers, both sophisticated sellers and buyers, I
14 was able to begin by saying what has been the
15 transaction price. And then I could move from
16 that transaction price to determine the value of
17 the various securities.

18 Q. And what transaction price are you talking
19 about?

20 A. Well, in the time frame you're talking
21 about, September until January of - September '87
22 to January of '88, the board authorized the
23 company to seek financing for a new security of
24 preferred C stock at \$2.90 a share. The company
25 began seeking that end, investors at that price.

1 There was preliminary interest on the part of some
2 investors for that price, and ultimately a
3 transaction was - or a buy and sell occurred in
4 December of 1987.

5 So if we're talking about this time
6 frame, the fact that that transaction occurred in
7 December, was authorized in September, is able for
8 me to serve as a benchmark as to the value of the
9 various securities in or around that time period.

10 Q. Despite the fact you felt the price was a
11 little high, that's the benchmark you used?

12 A. Sure, if other people, other sophisticated
13 investors are willing to pay at that price, that's
14 the value of the company irrespective of whether I
15 as an investor am willing to buy a lot at that
16 price or none at that price.

17 Q. Sir, did you use that as the benchmark for
18 determining the values of the D common and Tom's
19 common?

20 A. Yes, I did.

21 Q. Sir, why don't we go to the bottom line,
22 and then we'll see how you got there. With
23 respect to the D stocks did you determine its
24 value?

25 A. Yes.

1 Q. Did the value change appreciably in your
2 opinion between September and February of '88?

3 A. It did not change appreciably during that
4 period, no.

5 Q. Sir, what was your opinion of value, of
6 the fair market value of the D stock?

7 A. The fair market value of the D stock was
8 in my mind a range of value between \$1.50 and \$2 a
9 share. And for want of ease, I said that's
10 approximately \$1.75 a share was the value of the D
11 stock at the time of the trade, which would have
12 been - or the time of the closing of the preferred
13 C round, which would have been December of 1987.

14 Q. If I suggest to you that during that same
15 period Mrs. Stenberg negotiated the sale of those
16 shares for between \$2.25 and \$2.48 a share, would
17 you say that that's at least from her point of
18 view a fair price?

19 A. In my opinion that's a good price to sell
20 the securities at.

21 Q. With respect to the common shares which
22 had marketability, not Tom's common shares, did
23 you determine a value for the period between
24 September and February of 1988?

25 A. Yes, and the range--

1 MR. WALSH: Objection, Your Honor.

2 THE COURT: Just answer yes or no.

3 Is that your objection - the answer is going
4 beyond the question?

5 MR. WALSH: Yes.

6 THE COURT: The question before you
7 is whether or not you ever determined the value?

8 A. Yes.

9 Q. What is your opinion, sir?

10 MR. WALSH: Objection.

11 THE COURT: What's the basis of the
12 objection?

13 MR. WALSH: Basis is I'd like to be
14 heard with respect to a motion in limine for the
15 Court to hear the basis, methodology used, in
16 order to come to a price. His methodology, I
17 think, is in question here; and I would like to
18 have the opportunity at least to have the
19 foundation laid by Mr. Dwork to show what that
20 basis was and the method he used and to find out -
21 get a ruling preliminarily from this Court as to
22 whether or not that methodology is acceptable.

23 THE COURT: I'll take it de bene
24 subject to a foundation being laid. And if you
25 feel the foundation is inadequate, you can move to

1 strike; and I'll deal with it then under a motion
2 to strike. You can have it de bene.

3 Q. What is your opinion of the value of the
4 common stock?

5 A. One dollar to \$1.50 a share. That's the
6 common stock freely tradable and not subject to
7 forfeiture.

8 Q. With respect to Tom's shares of stock were
9 you acquainted with restrictions, buyback
10 agreements and other matters that pertained to his
11 stock as differentiated from other common stock?

12 A. Yes.

13 Q. And did anything of a substantial nature
14 occur between September, '87 and February, '88
15 with respect to his stock?

16 A. Yes. During that time period there were
17 certain forfeiture provisions which ceased to be
18 operative; and therefore, he vested into a larger
19 portion of his shares - I believe one-half of his
20 shares. He didn't entirely vest into them, but
21 there was a large step forward in terms of his
22 vesting right. He was still subject to certain
23 forfeiture provisions which did not disappear, but
24 others had disappeared; so he stepped into a
25 stronger position.

1 Q. In doing your determination of value did
2 you divide Tom's shares into that which was called
3 vested and that which was called unvested?

4 A. In my valuing of Tom's shares I looked at
5 those shares as of September, September of '87 and
6 December of '87, at which point they were subject
7 to a forfeiture provision.

8 Q. I'm not sure you responded to my
9 question. You have used two values?

10 A. I did not, but - I used the value for all
11 of his shares which were subject to forfeiture as
12 of September.

13 THE COURT: I thought you said that
14 \$1 to \$1.50 per share related to your opinion as
15 to the value of the stock not subject to
16 forfeiture?

17 THE WITNESS: That's the value of
18 the stock of a common shareholder, not including
19 Tom, as of September or January - would be \$1 to
20 \$1.50 a share. When Tom as of-

21 THE COURT: You're not speaking of
22 Mr. Stenberg's --

23 THE WITNESS: No, I'm speaking of
24 someone - of a security holder who had common
25 stock not subject to his restrictions.

1 THE COURT: Were there any
2 stockholders that had common shares not subject to
3 restrictions?

4 THE WITNESS: Yes, other employees
5 of the company. There were other consulting firms
6 or other providers of services that were given
7 stock that were not subject to his restriction.
8 His specific restriction, I believe, was limited
9 to him alone - which was, if he quit, we could buy
10 back his shares at a nominal price. If we fired
11 him, we could buy back a block of his shares at a
12 nominal price. There were a number of provisions
13 that we could buy back his shares at virtually
14 nothing, and he alone was subject to that
15 restriction.

16 THE COURT: Were those forfeiture
17 provisions operable in September of '87?

18 THE WITNESS: Yes, there were - in
19 looking at my notes there were six forfeiture
20 provisions that Tom was subject to as of September
21 of '87. And then after September - after January
22 of '88 there remained - there were two others that
23 also remained.

24 THE COURT: There remained two of
25 the six?

1 THE WITNESS: Yes, two of the six
2 after January 29 of 1988.

3 Q. And with respect to the other half, all
4 six continued to apply?

5 A. That's correct.

6 THE COURT: Sorry, I don't
7 understand your question. With respect to all six
8 applied - do I understand that all six forfeiture
9 provisions applied to all of Mr. Stemberg's stock
10 in September of '87?

11 THE WITNESS: Yes.

12 THE COURT: Will all of the common
13 shares?

14 THE WITNESS: Yes.

15 THE COURT: And in January of '88
16 there remained two of the six with respect to all
17 of the shares?

18 THE WITNESS: Actually I believe we
19 can look at them one by one. I believe two
20 applied after.

21 THE COURT: Two of the six applied
22 after January of '88?

23 THE WITNESS: That's right.

24 THE COURT: To all of the shares?

25 THE WITNESS: To 50 percent of the

1 shares.

2 THE COURT: We're going to take the
3 lunch recess. Do counsel agree - isn't the
4 operable date September of '89? As a practical
5 matter the deal was made in September of '87.
6 Presumably that's when the parties relied on
7 whatever they relied on. Isn't that the
8 critical--

9 MR. DWORK: Not only made on that
10 date, but thereafter positive affirmative actions
11 were taken to enforce the agreement by converting
12 to D stock and offering them for sale. So yes,
13 the parties went forward as of September.

14 THE COURT: It seems to me
15 September is the critical date, at least in terms
16 of when the parties entered into and bound
17 themselves by signing the contract and when they
18 relied on whatever they relied on prior to signing
19 the contract.

20 MR. WALSH: That's correct.

21 THE COURT: We'll take the luncheon
22 recess.

23 (Recessed, 1:00 p.m.)

24 (Resumed, 2:10 p.m.)

25 Q. (By Mr. Dwork) With respect to the value

1 of Mr. Stemberg's stock as of September of '87,
2 would you tell us what your valuation was?

3 MR. WALSH: Objection, Your Honor.
4 Can it be taken on the same basis, de bene?

5 THE COURT: I'll take it de bene
6 subject to some explanation as to what system he
7 utilized to arrive at or the basis for his
8 opinion.

9 MR. WALSH: Thank-you, Your Honor.

10 Q. As a matter of fact, let me strike it and
11 ask first about common. Did you arrive at a value
12 of the common stock?

13 A. Yes.

14 Q. And I assume de bene - would you tell us
15 what your value was for the common stock in
16 September of '87?

17 MR. WALSH: The same objection,
18 Your Honor.

19 THE COURT: I'll take it de bene.
20 You're talking about Mr. Stemberg's?

21 MR. DWORK: No, just the common
22 stock.

23 THE COURT: Not subject to the
24 forfeiture provision?

25 MR. DWORK: That's correct.

1 THE COURT: He did say as of
2 September of '87 that was worth between \$1 and
3 \$1.50 a share.

4 MR. DWORK: Sorry, Your Honor, I
5 just forgot.

6 Let's move to Tom's stock, and I
7 expect him - I assume de bene - would you tell us
8 what your valuation of his stock is.

9 MR. WALSH: Same objection, Your
10 Honor.

11 THE COURT: Same ruling. I'll take
12 it de bene.

13 A. On the basis of what would a willing buyer
14 pay to Tom if Tom was a willing seller of his
15 shares, I don't believe the stock would have any
16 value. Given the forfeiture provision applied to
17 Tom's stock, I do not believe he could sell his
18 stock to an arm's length buyer. Nevertheless, I
19 have applied a methodology, a probabilistic
20 methodology of various probabilities of Tom's
21 departure or being fired, and saying on that
22 basis, that Tom's stock would be worth about \$1.10
23 less per share than the standard common.

24 Given the fact that I said the
25 standard common was worth \$1.50 - let's be

1 generous and say \$1.50 - if you take \$1.10 away
2 from \$1.50, I would say Tom's stock subject to
3 forfeiture would be worth ten cents a share.

4 Q. In arriving at your conclusions as to the
5 variation values other than C - I think you said
6 you predicated them all with C as a benchmark?

7 A. That's correct.

8 Q. And without telling us what the figures
9 are, what was the systematology that you used in
10 order to arrive at these values?

11 A. I looked at each of the major rights that
12 were different between the different classes of
13 securities and assessed what the discount would be
14 applied by a professional investor to a security
15 with or without the particular right in question.

16 Q. And you did that with respect to D common
17 and Tom's common?

18 A. With respect to preferred D, standard
19 common and Tom Stemberg's common, yes.

20 Q. And it's no surprise to the other side
21 that you've done sort of a diagram; is that
22 correct?

23 A. Yes, I actually prepared notes for myself
24 in preparation for the deposition that was held in
25 June, and I have kept a copy of those notes which

1 I'm referring to now.

2 (Discussion off the record.)

3 Q. Mr. Romney, is this the skeleton from
4 which you worked?

5 A. Yes, it is.

6 Q. Why don't we start with the preferred C
7 which is the middle column. In your plan did you
8 put certain figures of values - or just to spell
9 out the characteristics of the preferred C--

10 A. What I did is I took the preferred C which
11 was valued at \$2.90 a share based on the C. If
12 you write \$2.90 above the preferred C - we know
13 that the preferred C is worth \$2.90 a share, and
14 it has the rights which you've described down the
15 center column, a liquidation preference.
16 Specifically, the preferred C will be paid back
17 \$2.90 a share plus a ten percent dividend each
18 year before any other security receives any cash.

19 Q. So would that be 29 cents a year?

20 A. Yes. It will get back - yes, that's
21 right. It will get a dividend of 29 cents.

22 THE COURT: Ten percent a year or
23 ten percent after the dividend?

24 THE WITNESS: I believe it's 29
25 cents a year.

1 THE COURT: Ten percent is always
2 based on the \$2.90?

3 THE WITNESS: That's correct.

4 THE COURT: \$2.90 a share plus 29
5 cents a year dividend?

6 THE WITNESS: That's correct. Then
7 I compared that with the preferred common and--

8 Q. Let's go further down. On the redemption
9 rights, did you put down a date for the redemption
10 rights to be exercised?

11 A. Yes, they existed through 12/31/91.

12 THE COURT: What does that mean
13 exactly?

14 THE WITNESS: Meaning that - I
15 don't want to refer to that. My recollection is
16 we had a right of redemption. We had a right to
17 call for our shares to be redeemed as of
18 12/31/91. Which means if the company had not been
19 sold or taken out, we could go to the company as
20 of December 31, '91 and demand they pay us \$2.90 a
21 share plus any accrued dividends. As of 12/31/91
22 we could get our investment back plus 29 cents a
23 share.

24 THE COURT: Not prior to December
25 31?

1 THE WITNESS: No, not prior.

2 (Discussion off the record.)

3 THE COURT: What happens if you
4 don't exercise it on December 31, '91 and go to
5 January, '92?

6 THE WITNESS: It would continue to
7 carry forward.

8 THE COURT: Any time after?

9 THE WITNESS: The best of my
10 recollection is you have that right as of December
11 31, '91, and it continues forward. To find that
12 specifically I need to look once again at the
13 document. It's not fresh in my memory.

14 Q. Now, under registration rights did you
15 make some notation in your records?

16 A. I have down there demand and piggy.

17 THE COURT: You skipped something
18 there.

19 THE WITNESS: Do you want to
20 discuss the other--

21 THE COURT: Are you going to
22 discuss these in order? You've covered dividend
23 and redemption.

24 MR. DWORK: I just wanted to put
25 down what we have.

1 THE WITNESS: Under the term
2 registration I had written demand and piggy.

3 Q. That completes everything you wrote under
4 that column?

5 A. That's right.

6 Q. Under preferred C it's \$2.90 a share,
7 which is the price actually paid?

8 A. That's correct.

9 Q. Would you go through each one and tell us
10 what the significance of these items are?

11 A. Yes, with regards to liquidation, the
12 preferred C - I've described the right - which is
13 \$2.90 a share. The common also had a liquidation
14 right; and that is, that the common had a
15 liquidation right of 80 cents a share, meaning
16 that in liquidation of the company the common
17 would receive 80 cents a share. However, that 80
18 cents liquidation right would be valuable only
19 after the preferred A had been liquidated, the
20 preferred B had been liquidated and the preferred
21 C had been liquidated, including any accrued and
22 unpaid dividends. So the common's liquidation
23 rights occurred after all the other preferred
24 shares had been liquidated at their face value
25 plus accrued dividends.

1 THE COURT: What about D?

2 THE WITNESS: D was slightly better
3 than that in that from my perspective D had a
4 liquidation right of 50 cents a share after the
5 preferred A, the preferred B and the preferred C
6 but before the common.

7 THE COURT: So Class D had
8 liquidation rights at 50 cents a share?

9 THE WITNESS: That's correct.

10 THE COURT: But only after A, B and
11 C and prior to the common?

12 THE WITNESS: Prior to the common;
13 that's correct.

14 Q. If we stop then at the liquidation, sir -
15 based upon the different attributions of the three
16 classes did you make any adjustments on the \$2.90
17 price?

18 A. Yes. From my experience if a company
19 offered me preferred C with the liquidation right
20 I've described or common with a liquidation right
21 that I've described for the common, and said the
22 preferred C is going for \$2.90, I'll sell you some
23 of this common that has this different liquidation
24 right, what will you pay for the common? I would
25 pay 25 to 35 percent less for the common of a

1 company in the stage. Staples at the time we're
2 describing - that's the approximate discount I
3 would apply. And so at 25 to 35 percent it's 75
4 cents to a dollar less, so I'd pay for the common
5 75 cents to a dollar less than I'd pay for the
6 preferred C.

7 Q. In your diagram you put it in parentheses
8 to show a minus?

9 A. That's correct. If that were the only
10 difference between preferred C and common, I would
11 pay for that common \$2.90 less - let's say a
12 dollar or \$1.90 a share.

13 Q. If we can move to the preferred D, did you
14 compare the preferred D to the preferred C on the
15 same basis?

16 A. Yes, and on the preferred D the discount
17 was not quite 70 cents to a dollar a share. I
18 assessed the discount at approximately 50 cents a
19 share, and said for preferred D security I believe
20 a professional investor would want a lower price
21 relative to a preferred C of about 50 cents a
22 share or about 15 to 20 percent less than what
23 would be paid for the preferred C.

24 THE COURT: That's what - 50 cents
25 a share less; is that what you're saying?

1 THE WITNESS: That's correct. So
2 if the only difference between these three
3 securities were the liquidation preference, if the
4 preferred C is worth \$2.90, the common in my
5 opinion would be worth somewhere between \$2.15 to
6 \$1.90. All right--.

7 THE COURT: \$2.15--

8 THE WITNESS: \$2.90 less 75 cents
9 is \$2.15, I believe.

10 THE COURT: Sorry?

11 THE WITNESS: I'm not great at math
12 when I'm on the stand.

13 THE COURT: \$2.15 to \$1.90?

14 THE WITNESS: Something in that
15 range would be the common, if that were the only
16 difference. And the preferred D would be
17 approximately \$2.40 a share.

18 Q. See if we can go to the next item of
19 dividend, 29 a share. Let's talk about the
20 common. What was the difference in
21 characteristics?

22 A. Again, if the only difference between the
23 two securities were the dividend right, and the
24 preferred C were worth \$2.90 a common that did not
25 have that dividend right, I would pay some three

1 to five percent less or ten to 15 cents less. I
2 have written in there a discount of ten to 15
3 cents.

4 Q. With respect to the common there were some
5 dividend rights, were there not?

6 A. No.

7 Q. Well, at some point in time, if all of the
8 preferred got their dividends, there could be a
9 vote for common dividends?

10 A. The board could always decide to pay
11 various securities dividends, but there were no
12 dividend rights in the common.

13 Q. There were no rights, but there was a
14 possibility in the future; is that correct?

15 A. Yes.

16 Q. And based upon that situation you deducted
17 ten to 15 cents?

18 A. That's correct.

19 Q. How about the preferred D?

20 A. The preferred D likewise had no dividend
21 and was exactly the same as common. I discounted
22 that at ten cents. Obviously, the same range
23 would apply, ten to 15 cents, but in my note sheet
24 here I only wrote down ten cents.

25 Q. You have no objection to my writing ten to

1 15?

2 A. That's fine. To show you the methodology
3 to make sure we are doing the right thing or
4 communicating properly - if again the only
5 difference between preferred C and common were
6 these two things, then I'd take the \$2.90 less the
7 75 cents to a dollar, less also the ten to 15
8 cents, and that would bring the value up, common
9 down by that combined amount.

10 Q. The next move is redemption rights. Did
11 the common have any redemption rights?

12 A. The common did not.

13 Q. And how about the preferred D?

14 A. Likewise, it did not.

15 Q. Based on that what, if any, adjustments
16 did you make?

17 A. Redemption right is more valuable to me as
18 an investor; and therefore, my reduction in value
19 is some 20 to 30 cents a share for this redemption
20 right or as much as ten percent in value without a
21 redemption right. In the case of the common a
22 reduction of 20 to 30 cents, and the same with the
23 common would prevail.

24 The reason for that is that
25 investors in early stage companies are concerned

1 about a condition which may occur which is that
2 the management runs the company well and is able
3 to pay themselves a good salary, but the company
4 is never able to be sold to the public market
5 because it never does that well and is never able
6 to be sold to another corporation because the
7 corporation doesn't have that potential. So the
8 company lives on year after year generating a
9 little bit of money but never paying the
10 investors.

11 A redemption right allows you to
12 say to the company, Pay us our money back; we want
13 out. Without that right I would want to discount
14 the security by some ten percent, and hence, that
15 decrease in value.

16 Q. Now the next thing is an antidilution
17 provision in the preferred C, and did either the
18 common or preferred D have that?

19 A. They did not.

20 Q. What is an antidilution--

21 A. Antidilution simply is that if there's a
22 subsequent round of investment at a lower price,
23 then the investment I will have just made will be
24 converted to that lower price so that I'd get more
25 shares. It protects me in the event there's a

1 subsequent round of investment at a lower price.

2 Q. Without those antidilution provisions what
3 adjustments would you have made on both?

4 A. Approximately ten cents reduction in value
5 for each, and we're now talking about
6 approximately a three percent reduction in value.
7 Again, if the only difference between preferred C
8 and, let's say, common were an antidilution right,
9 I'd probably pay \$2.90 for the preferred C and
10 something like \$2.80 for the common.

11 Q. And next, sir, is a class vote. What did
12 you mean--

13 A. I meant that the preferred C had the right
14 to vote as a class in certain matters such as
15 sale, merger, acquisition or ability to block
16 certain financial transactions which would be
17 detrimental to the class. This class vote gives
18 the people who invest in this finance round of
19 security powers greater than they would have if
20 all the shareholders voted together. That is a
21 right which is valuable in certain contentious
22 circumstances when management wants to go in a
23 direction that the board did not want agree with.
24 In this case I did not value that highly - five
25 cents a share, or one or two-and-a-half percent.

1 Q. And neither D nor common had the class
2 vote?

3 A. That's correct.

4 Q. Registration rights, you said demand and
5 piggy. Could you explain these attributes?

6 A. Registration rights generally are the
7 rights of the holder of the securities to demand
8 that the company be taken public. And the term
9 demand is a term which relates to that right of a
10 demand, registration to demand that a company be
11 taken public and that the shares of securities,
12 the preferred C here, being registered with the
13 SEC; and therefore, be able to be freely tradable
14 in the marketplace.

15 And the reason for these rights and
16 the value of these rights is that it allows the
17 company - the investors of preferred C, excuse me
18 - to insist that the company register their shares
19 so they can sell them in the marketplace someday.
20 A company may not wish to do so. This is an
21 action in effect one holds over the management's
22 head to say, You better get us out of our
23 investment or we will demand that the company be
24 taken public at a value which is attractive to
25 us.

1 And in this case the discount I
2 applied for securities without registration rights
3 was approximately ten cents a share.

4 Q. And you talked about piggyback?

5 A. Piggyback rights indicate that if the
6 company decides of its own accord to register some
7 of its securities, there is a cost associated with
8 doing so. Piggyback rights allow an investor in
9 the preferred C security to, in effect, piggyback
10 the registration statement prepared by the company
11 for its own shares or other shares, and to make
12 sure that our preferred C shares are registered
13 with the SEC at the same time and for no
14 additional cost to the investor.

15 Q. I think you already testified those
16 rights. You attributed a ten cent reduction for
17 the failure of those classes to have it?

18 A. That's correct.

19 Q. Next we have the pre-emptive rights, and
20 the pre-emptive rights again are what?

21 A. The pre-emptive rights allow an investor
22 that holds preferred C shares in the event of a
23 subsequent distribution or financing where more
24 money is coming into the company, allow the holder
25 of preferred C to insist on its prorata share of

1 any new money going into the company. It allows
2 an investor of preferred C, therefore, to maintain
3 its prorata ownership of the company.

4 That becomes particularly important
5 if one thinks that the subsequent round of
6 financing is being offered at too low a price.
7 You'd want to have the right to invest your money
8 to make sure that you would not be diluted by
9 someone else who is coming in at a lower price.

10 Q. And those were characteristics that common
11 and preferred D did not have?

12 A. That's correct.

13 Q. What deduction did you make for the
14 failure to have that?

15 A. Ten cents per share.

16 THE COURT: It gives you the right
17 to acquire additional stock at the same prorata
18 share of your prior investments?

19 THE WITNESS: That's correct.

20 THE COURT: If you have 25 percent
21 of the stock offered, for example, it would give
22 you the right to purchase 25 percent of a new
23 issue?

24 THE WITNESS: Exactly.

25 Q. Now, sir, did you in your diagram then

1 come to a total of some sort?

2 A. Yes, I drew a line there because the next
3 two items that you have are transfer and
4 forfeiture, and those only apply to Tom Stemberg's
5 stock specifically. I drew a line here to
6 delineate the end of what I'll call the standard
7 common or the non-Tom Stemberg common. I did not
8 total all of the above discounts; but if I do
9 total all of the above discounts, it ranges from
10 \$1 and 40 cents worth of discounts to \$1.80 of
11 discounts. And if one then subtracts that from
12 \$2.90--

13 Q. Ends up with a net of what?

14 A. Ends up with a net of \$1.10 a share and
15 \$1.50 a share.

16 Q. And are you calling that fair market
17 value?

18 A. Yes. Now, as a test of my methodology,
19 which is an item by item rights discount, I also
20 stopped at this point and said if someone came to
21 me with this preferred, preferred C, and that
22 common with all that difference, what's the
23 difference that would be paid in the marketplace
24 for those two different securities? And the total
25 I have there seems approximately correct. My

1 conclusion was I'd pay about a dollar for the
2 common versus \$2.90 for the preferred C. My
3 calculation took me to \$1 to \$1.50.

4 Those were close enough that I had
5 my range of \$1.10 to \$1.50 as the value of the
6 common stock. I'm sorry I'm not able to be more
7 specific than that as to whether it's \$1.10 or
8 \$1.12 or 19, but that's about as close as I could
9 come.

10 Q. A dollar to \$1.50?

11 A. That's correct.

12 Q. Moving to the other side on the preferred
13 D, you made your final determination on preferred
14 D based upon these figures?

15 A. That's correct.

16 Q. And where did you end up, sir?

17 A. I ended up with a discount of \$1.55. If
18 we add those up from up above - I'm trying to read
19 the one number. I can't read the one number. We
20 can add it up.

21 Q. Sir, because we have changed yours a
22 little bit, would it be fair to say that the
23 adjustment could be another 15 cents to compensate
24 for the 30?

25 A. It's \$1.15 to \$1.55 is the range of

1 discount applied. And again, subtracting those
2 numbers from \$2.90 will give me the value of the
3 preferred D. So if I take \$2.90 and take away
4 \$1.15, I have \$1.75 for the value of preferred.
5 And at the other end of the range if I take \$2.90
6 and subtract \$1.55, I have \$1.35 as the value of
7 the preferred D.

8 Q. So between \$1.35 and \$1.75?

9 A. That's correct.

10 Q. Now, sir, are we now through with the
11 calculations for the common common, if you will,
12 and for the Class D?

13 A. That's correct.

14 Q. Did you make some further calculations to
15 arrive at a value of Tom's common?

16 A. Yes.

17 Q. What did you do, sir?

18 A. I assessed a probabilistic discount
19 associated with forfeiture, and therefore, applied
20 a further discount to Tom's stock based on the
21 forfeiture provisions. I also looked at the
22 transfer restriction and assessed a cost to a
23 transfer restriction.

24 Q. Well, let's get the figures and see how
25 you broke it down, if you will. On the transfer

1 are you talking about the fact that Tom could not
2 freely transfer his shares?

3 A. Yes, Tom Stemberg's shares could not be
4 transferred until after January of '90, and they
5 would not be saleable, transferrable shares; and
6 the fact that any shares subject to that kind of
7 restriction would be less valuable than shares not
8 subject to that kind of restriction. And in my
9 assessment it's approximately a ten to 15 percent
10 reduction of value by virtue of that lack of
11 transferability; and hence, I subtracted 30 cents
12 from the Tom Stemberg shares for lack of
13 transferability.

14 This is like the other rights I'm
15 looking at. This is a deduction in value which is
16 quite commonly assessed in looking at the
17 different rights and values between different
18 classes of securities. Most of the securities
19 that we have in our portfolio are private. We
20 assess a 15 percent deduction in value for all of
21 our private securities. In this case this
22 transfer strikes me as being that similar type of
23 restriction.

24 Q. And next, sir, you have forfeiture. And
25 by forfeiture you mean those six items you were

1 talking about?

2 A. That's correct.

3 Q. It's fair to say that there had also been
4 one prior - in the event of Tom's death before a
5 particular date there would also be a forfeiture?

6 A. Yes, there were actually four forfeiture
7 provisions. I refer to them - the seventh was, I
8 believe, death prior to January of '87.

9 Q. That had already passed?

10 A. Yes, and was no longer included in my
11 thinking.

12 Q. That left six forfeitures; is that
13 correct?

14 A. That's right.

15 Q. Of the six did any remain after January of
16 1988?

17 A. Yes, I said a moment ago that two of those
18 remained. In looking carefully at my notes,
19 actually three remained after January of '88.

20 Q. And this is as to the stock that's
21 so-called vested?

22 A. Yes.

23 Q. Well, let's first talk about the
24 unvested. Did the six remain with respect to the
25 unvested?

1 A. Let's see, the forfeiture provision really
2 is the vesting provision.

3 THE COURT: One and the same,
4 aren't they?

5 THE WITNESS: Yes, one and the same
6 thing. So I don't quite understand how to respond
7 to the question.

8 Q. In January of 1987, 50 percent of his
9 shares vested; is that correct - what you would
10 call vested? '88, sorry.

11 A. In January of '88, 50 percent of his
12 shares became less subject to forfeiture than they
13 had before; but indeed, literally 100 percent of
14 his shares remained subject to some kind of
15 forfeiture. Specifically, one of the provisions
16 was if Tom decided to compete with the company
17 prior to January 26 of 1990, the company could
18 repurchase all of his shares at a nominal value.
19 So he was still subject to that even after January
20 of 1988.

21 THE COURT: If he competed prior to
22 what date?

23 THE WITNESS: January 26 of 1990.
24 So that even after January of 1988 the shares were
25 still subject to some form of forfeiture

1 provision. Clearly, that forfeiture provision was
2 in Tom's control, but as a buyer of securities in
3 a market - if there were a market for these
4 securities, I would not be willing to buy
5 securities where I could pay good money one day
6 and the next day have someone else quit, compete
7 and have my shares worth nothing.

8 THE COURT: Getting back to the
9 forfeiture provision, just briefly summarize - you
10 said there were seven. One you said was death
11 prior--

12 THE WITNESS: Prior to the date of
13 September, '87. I'm not sure what date--

14 Q. January, you mean?

15 A. I'm just trying to recall - he had to pass
16 away by--

17 Q. Would these notes help you refresh your
18 memory?

19 A. Yes, the death was prior to January 29 of
20 '86, and that time had passed; so that death
21 provision was gone. It might be worth to sort of
22 write down the seven. One was death prior to
23 January 29 of '86. That was gone. That's death
24 pre-1/29/86. Might leave a little space to the
25 right because we may come back to this. The next

1 one is competes, if Tom were to compete before
2 1/26/90. If he were to compete before 1/26/90, we
3 had the right to buy back 100 percent of his
4 shares at a nominal value. You might write that
5 next to it.

6 MR. WALSH: Excuse me, could we
7 have the document the witness is examining
8 identified?

9 MR. DWORK: As a matter of fact,
10 it's been marked for identification.

11 THE COURT: You're free to.

12 THE WITNESS: Exhibit 5 from my
13 deposition.

14 THE COURT: As you know the witness
15 can look at anything he wishes to refresh his
16 memory. You can look at anything you want.

17 MR. WALSH: I just want it
18 identified for the record.

19 MR. DWORK: It was marked in Mr.
20 Goodman's--

21 MR. WALSH: Titled terms and
22 conditions. If I could just see it - it's marked
23 K for identification. Thank-you, Your Honor.

24 A. Then my next item is marked quit before
25 1/29/88. So if Tom quits before January 29 of

1 '88, the company has the right to purchase 100
2 percent - write 100 percent next to that.

3 THE COURT: By the way, when you
4 say at nominal value, was it a fixed sum?

5 THE WITNESS: I think it was a
6 one-tenth of a cent per share.

7 THE COURT: One-tenth of one cent?

8 THE WITNESS: It could be one
9 one-hundredth. It was a small number.

10 Q. Did it vary from time to time, .0001 and
11 .25?

12 A. I believe it was in that range.

13 THE COURT: It was subject to a
14 written agreement?

15 THE WITNESS: That's correct.

16 THE COURT: Do counsel agree to
17 what it was?

18 MR. WALSH: It's in the agreement.
19 I can look it up.

20 THE COURT: .0001, is that a
21 thousandth of a cent.

22 MR. STEMBERG: I think it's 200
23 thousandths of a penny.

24 Q. In any event it was under a penny share?

25 A. Yes.

1 THE COURT: Less than a penny a
2 share?

3 THE WITNESS: Yes.

4 Q. What was the next?

5 A. Quit by 1/29/90, and in this case this
6 would be referring to the circumstance where Tom
7 would quit between 1/29/88 and 1/29/90. If he
8 quit during that period we could buy back 50
9 percent of his securities at this nominal price.

10 MR. WALSH: I think it's Exhibit
11 29. I believe the price is - purchase price paid
12 per share by the purchaser, which in this case I
13 think would be Mr. Stemberg, what he paid.

14 THE COURT: His acquisition cost?

15 MR. WALSH: Yes.

16 THE COURT: Do counsel agree with
17 what that was?

18 MR. WALSH: It was literally
19 nothing.

20 MR. STEMBERG: I would object -
21 \$40.

22 MR. DWORK: It wasn't nothing. It
23 was \$40.

24 THE COURT: You accept that?

25 MR. WALSH: We'll accept that

1 figure, yes.

2 MR. DWORK: Of course, there was
3 some preferred Tom stock, but we're not talking
4 about--

5 THE COURT: With restrictions the
6 witness has now described?

7 THE WITNESS: If he were to quit
8 voluntarily between January of '88 and January of
9 '90, the company could buy back half of his shares
10 at this \$40 value.

11 I have three more conditions to
12 fill in here, so better plan ahead. The next one
13 is fired for cause by 1/29/88, and that had a 100
14 percent repurchase provision. The next is fired
15 without cause before January, 29, '88; and were
16 that to occur, we had the right to purchase 50
17 percent.

18 And the last provision I have is
19 fired with or without cause between 1/29/88 and
20 1/29/90. And here we have the right to buy back
21 50 percent less 6.25 percent for each quarter
22 which passed after 1/29/88, for each quarter of
23 the year. So for each three months after 1/29/88
24 that 50 percent buyback right was reduced by 6.25
25 percentage points.

1 THE COURT: 6.25?

2 THE WITNESS: Yes.

3 Q. Do I have it right, sir?

4 A. That's correct.

5 THE COURT: Said another way, his
6 shares vested at the rate of 6.25 per quarter
7 after January 29, '88?

8 THE WITNESS: That's correct.

9 Q. That's seven.

10 A. Those are the seven provisions. And I
11 said to you that in my looking at them, that three
12 survived after January 29 of '88.

13 Q. Can we first start with September of '87?
14 Is it fair that the only one which had expired was
15 number one?

16 A. That's correct, that's death prior to
17 1/29/86.

18 Q. Expired before 9/22/87. The others
19 remained in effect until late January, '88?

20 A. Correct.

21 Q. And then what expired at that point?

22 A. At that point the number three, which is
23 quit by 1/29/89 was gone. Number five, fired for
24 cause by 1/29/88 was gone. And the next number
25 six, fired without cause by 1/29/88 was gone. And

1 so three restrictions remained. Number two which
2 is compete by 1/26/90 applied to all of the shares
3 Tom had.

4 Q. 100 percent?

5 A. That's right. And the other two which
6 applied, which is quit by 1/29/90, applied to only
7 half the shares. And the last one I described,
8 which is fired with or without cause, applied to
9 as much as half of the shares; but that would be a
10 declining balance after 1/29/88.

11 Q. Okay. Based upon that I guess we go back
12 to the prior schedule; is that correct?

13 A. Yes. The calculation of the forfeiture
14 discount which I applied to Tom's shares was based
15 upon a subjective assessment of the probability of
16 each of the events on the previous page occurring;
17 which is, our firing Tom, his competing against
18 the company, etc. I looked at each of those and
19 assessed what I thought the probability was of
20 those things occurring, and on the basis of that
21 calculated a discount for forfeiture.

22 Q. What did you calculate?

23 A. 80 cents a share.

24 Q. And those are the only two items you
25 looked at which distinguished Tom's shares from

1 the other shares?

2 A. Yes, they are.

3 Q. After making those deductions, sir, what
4 figure did you come up with for Tom's shares?

5 A. You recall that the common, the straight
6 common, not Tom's common, I valued at between \$1
7 and \$1.50 a share. If I take away the 30 cents
8 and 80 cents, at the low end of the range that
9 means his value is zero; and at the high end of
10 the range his value is 40 cents a share.

11 Q. Based upon that did you try to narrow that
12 down to a figure?

13 A. I said in my own mind 25 to 50 cents is
14 probably the kind of value a speculator might pay
15 for Tom's shares. I note again that I think a
16 professional investor would not be willing to
17 purchase Tom's shares subject to these
18 provisions. But perhaps a speculator or gambler
19 who looked at the probabilistic theory would say
20 I'd pay that kind of price.

21 Q. With respect to the forfeiture - I'm not
22 going to ask you to go through it - do you have
23 your written breakdown as to how you arrived at
24 percentages to come up with an 80 cent deduction
25 for forfeiture?

1 A. Yes. Again, I looked at each forfeiture
2 provision, assessed the probability of Tom
3 quitting by certain dates, being fired for cause
4 or without cause by certain dates, applied the
5 penalty that would have associated with it to
6 Tom's shares, and then did a weighted average of
7 all of those probabilities, added up the penalty,
8 and it was 80 cents a share.

9 Q. To leave your valuation of stock, I'd like
10 to just go into one area, I believe. You were on
11 the board of directors when Tom asked the board to
12 approve the issuance of D class stock in order to
13 resolve his marital problems?

14 A. That's correct.

15 (Discussion off the record.)

16 Q. You're aware then that Tom effectively
17 transferred to Maureen 400,000 shares of his
18 common at that time, which was accepted back by
19 the company and for which they issued Class D
20 stock in the same number?

21 A. That's correct.

22 Q. Sir, if Tom had come to you at that time
23 as a member of the board of directors and asked
24 you to vote to issue - let's take a figure - 50
25 percent of his stock claim, had asked you to vote

1 to approve that for a transfer to the Class D from
2 class common so that he could convey it to Mrs.
3 Stenberg for the purposes of her selling or
4 holding onto it for that matter, what would have
5 been your reaction?

6 MR. WALSH: Objection, Your Honor.

7 THE COURT: I'll hear you.

8 MR. WALSH: The same objection I
9 raised with regard to Mr. Goodman on substantially
10 the same question. It calls for speculation.
11 It's based upon hindsight, now looking back what
12 would he have done had something been presented.
13 I don't think there's testimony that such as
14 proposal was presented to the board. In fact, I
15 think it's the opposite.

16 THE COURT: I understand that, but
17 there's been varying evidence from Mrs. Stenberg
18 that she believed she was getting half of the
19 marital assets at the time and some evidence from
20 her that in her view that included half the
21 stock. Mr. Dwork cross-examined her as to how
22 half the assets could be half the stock and the
23 house. There was evidence put in through
24 correspondence from Mr. Levy that infers a demand
25 was made on behalf of Mrs. Stenberg for one-third

1 of the stock, and there was a response from Mr.
2 Stenberg's attorney to the effect that that was
3 never acceptable to Mr. Stenberg.

4 I think I'm inclined, having in
5 mind that there's evidence during negotiations as
6 to whether or not there was any likelihood of
7 those demands being met - because there was
8 subsequent evidence offered that Mr. Stenberg was
9 not in a position to agree to those kinds of
10 terms, and that that might somehow jeopardize his
11 employment - I'm going to let it in as
12 corroborative on the issue of whether or not (a)
13 his employment might be jeopardized by excessive
14 demands, if he exceeded to what he viewed as
15 excessive demands; and (b) whether or not there
16 was any likelihood of had they reached such an
17 agreement that the board would have approved it to
18 begin with. I'll let you have it.

19 MR. WALSH: The only point I was
20 raising - I don't think there's any testimony that
21 that type of proposal was indeed put to the
22 board. And the difficulty you have here - this
23 witness may give one answer; and Mr. Goodman would
24 say had such a proposal been made, he would have
25 agreed.

1 THE COURT: I agree that perhaps
2 makes the evidence less valuable. I agree, Mr.
3 Walsh, he can only testify to what he would have
4 approved, not what someone else would have
5 approved. But for the purposes of understanding
6 the alleged constraints on Mr. Stemberg's
7 bargaining position, what he alleges he was able
8 to do and unable to do and corroboration of that
9 position, I'll let it in.

10 Q. Do you have the question in mind?

11 THE COURT: You can have the
12 question. I agree with you, Mr. Walsh, he
13 certainly can't testify as to what position the
14 board would have taken. He can only speak for
15 himself. You can have the question.

16 A. I believed that the amount that Tom had
17 requested and said was necessary was at the outer
18 bounds of what the company should provide; and
19 therefore, I would have resisted and would have
20 voted against a proposal to extend the conversion
21 from common D to preferred D in a larger amount.
22 I was resistant at the number and was wishing one
23 could find an alternative way of satisfying Tom's
24 needs without having to make a conversion of the
25 nature that was being proposed.

1 Q. Now, at the time that the D conversion
2 was, in fact, agreed to, you were the owner, you
3 or your company were the owner, of both A and B
4 classes?

5 A. That's correct.

6 Q. And intended owners of the C class?

7 A. That's correct.

8 Q. And I think you testified this morning,
9 but I'll ask you - you don't recall what
10 percentage you owned of the A stock?

11 A. I'm sorry, of the A stock - let's see.

12 THE COURT: I think he said he
13 invested 1.5 million out of four. Four-and-a-half
14 million was raised, and you put in 1.5?

15 THE WITNESS: I think I overstated
16 that. I think that's including my A and B.

17 THE COURT: You were including
18 both?

19 THE WITNESS: Yes, I was including
20 both, so I'll go back.

21 THE COURT: You'll wait until
22 tomorrow?

23 THE WITNESS: I think that may have
24 been A plus B, so I'll come back with that.

25 THE COURT: We'll wait for tomorrow

1 and get your participation in A, B and C both as
2 to volume of dollars you invested and what
3 percentage of the funds that were raised on each
4 round that you participated in.

5 THE WITNESS: Fine.

6 THE COURT: By the way, as long as
7 the subject has been raised I'll ask it myself -
8 would you, not speaking for the board, but would
9 you have objected to a transfer of a percentage of
10 Mr. Stemberg's stock that would not be converted
11 into preferred D; that is, if Mr. Stemberg had
12 come to the board - there was an alienation
13 restriction provision with respect to his common
14 stock you testified to - had Mr. Stemberg come to
15 the board and said, 'I want that lifted because I
16 want to furnish my wife as part of the divorce
17 proceeding with some percentage, a third or
18 whatever it is, half, some percentage of my common
19 stock. I'm not seeking to have it converted to
20 preferred D' - you would have had a right to have
21 a say in that, I presume?

22 THE WITNESS: Yes.

23 THE COURT: If he had asked for
24 lifting of that restriction for an amount of
25 either a third or half of his common shares

1 without the request for the conversion to
2 preferred D, what would your position be?

3 MR. DWORK: Your Honor, I think
4 that assumes a fact - in point of fact, Tom had
5 that right to transfer within the family.

6 THE COURT: He had that right?

7 THE WITNESS: To his wife.

8 THE COURT: So you had no say with
9 respect to an inter-family transfer?

10 THE WITNESS: Not with respect to
11 his current wife. Subject to all the conditions
12 that his stock was --

13 THE COURT: Any stock Mrs. Stenberg
14 took with respect to the common stock was subject
15 to the same limitations presumably that Mr.
16 Stenberg's stock was?

17 THE WITNESS: That's correct.

18 THE COURT: She gained no greater
19 rights?

20 THE WITNESS: That's correct.

21 THE COURT: You only had a say or
22 you and the rest of your board only had a say as
23 to the conversion process?

24 THE WITNESS: We had a legal right
25 to block the conversion. We would have definitely

1 had a say.

2 THE COURT: You had a right to
3 block the conversion from common to C?

4 THE WITNESS: Yes. We would have
5 been displeased for him to transfer to a wife he
6 was divorcing.

7 THE COURT: You would have been
8 displeased but had no right to block a conversion
9 of common?

10 THE WITNESS: That's right.

11 THE COURT: But you had not the
12 reverse for the second one?

13 MR. DWORK: He could transfer
14 100,000 shares of common to his wife without
15 anyone's permission.

16 THE COURT: Without the board's
17 approval?

18 MR. DWORK: That's right. Your
19 Honor, I'd like to further question this witness
20 concerning his voting after he knows what
21 percentages of stocks he owns. I have no further
22 questions, but I'd like to--

23 THE COURT: You want to reserve
24 right to inquire as to percentage?

25 MR. DWORK: His voting powers in

1 order to stop a further transfer or changeover
2 from common to D.

3 THE COURT: And I assume, Mr.
4 Walsh, you're reserving the rights to, obviously,
5 cross-examine on that additional direct?

6 MR. WALSH: Yes, Your Honor. As
7 long as it's limited to just that purpose, I have
8 no objection to that. But I thought--

9 THE COURT: Limiting it to what his
10 powers then were with respect to blocking various
11 requests by Mr. Stemberg.

12 MR. DWORK: That's correct.

13 MR. WALSH: The only issue I raise
14 in that connection, I thought we just established
15 that the witness had the right to block the
16 creation of the D, but no say in just a simple
17 transfer to - I'm not sure--

18 THE COURT: That's my
19 understanding. The question is what percentage
20 did he own. And any requests whether it be in
21 regard to the stock or something else, presumably
22 we don't know whether he was in a position
23 single-handedly--

24 MR. DWORK: Yes, single-handedly to
25 stop further conversion from common to D if he

1 didn't like it.

2 THE COURT: That is, if he alone
3 didn't like it?

4 MR. DWORK: Yes.

5 THE COURT: That's reasonable. You
6 can't let those questions be asked, I suppose,
7 until you determine whether he had the right to
8 block it single-handedly.

9 THE WITNESS: By virtue of the
10 class vote.

11 THE COURT: Could you explain that
12 class vote one more time? Let me look at my notes
13 for a minute. You talk pretty quickly. You said
14 it was the ability to block financial decisions
15 detrimental to the Class C or the preferred stock.

16 THE WITNESS: Actually Class C.

17 THE COURT: What does that exactly
18 mean? When you say you had the ability, that one
19 member of the class could stop the --

20 THE WITNESS: No, the majority of
21 the class.

22 THE COURT: Required a majority of
23 the class?

24 THE WITNESS: That's correct. So
25 for instance, let's say the shareholders in total

1 wanted to raise a new round - we'll call it
2 preferred E - at 75 cents a share, and the total
3 shareholders wanted to do that. And yet the
4 shareholders of our class preferred C, we did not
5 want that. We'd have the right even though all
6 the shares counted, one man, one vote didn't want
7 to do it. So it gave this class super rights with
8 regards to blocking certain transactions and
9 subsequent financings, sale, merger, etc., that we
10 did not feel were appropriate.

11 THE COURT: By the way, did the
12 common shares have voting rights attached to it?

13 THE WITNESS: I believe they did,
14 yes.

15 THE COURT: So they had the right
16 to vote equally with the preferred one for one?

17 THE WITNESS: That's correct. On
18 those items that were decided as a total company
19 they voted. Nevertheless, the power was held by
20 the various classes, the Class A, Class B and
21 Class C that could vote as classes.

22 THE COURT: If they voted as
23 classes presumably - when they voted as classes,
24 they only had the right when they voted as
25 classes, as I understand it, to block decisions of

1 management detrimental to their holdings?

2 THE WITNESS: That's correct.

3 THE COURT: They didn't have the
4 right to vote as a class and block management
5 decisions?

6 THE WITNESS: That's correct.

7 THE COURT: For example, the
8 opening of another store--

9 THE WITNESS: There were limited
10 rights, the class vote, and Class A had class
11 rights, and Class B had class rights.

12 THE COURT: Each class had its own
13 right?

14 THE WITNESS: For instance, if I
15 had been fortunate to hold 51 percent of Class A,
16 I alone could block various financial transactions
17 with that kind of provision in any one class.

18 THE COURT: In a nutshell those
19 transactions could be summed up by the raising of
20 new capital?

21 THE WITNESS: Yes, which in a
22 company in this stage is its life blood. So you
23 have the power really to demand whatever you want
24 to because if you deny the right to money, you
25 deny the right to life.

1 THE COURT: What about borrowing
2 capability of the corporation, could you block
3 that as well?

4 THE WITNESS: Yes.

5 THE COURT: You could block the
6 raising of capital, not only by the issuance of
7 additional shares, but you could block it by
8 vetoing requests to make commercial loans?

9 THE WITNESS: Certain access to
10 capital we could block; others we could not. All
11 access to capital which would be senior to our
12 class we could block. Access to capital which
13 would be junior in preference or liquidation right
14 I do not believe we had the right to block.

15 THE COURT: All right. So you're
16 going to suspend basically with your direct
17 examination, and you're reserving the right to get
18 into percentages you required and powers.

19 MR. DWORK: That's right.

20 THE COURT: Mr. Walsh.

21 MR. WALSH: First, Your Honor, I'd
22 like to renew the motion at this time to strike
23 the opinion testimony of the witness.

24 THE COURT: With respect to which
25 class of stock?

1 MR. WALSH: With respect to the
2 common and the D.

3 THE COURT: What's the basis?

4 MR. WALSH: And both commons, the
5 so-called general common, although they're all one
6 class, Mr. Stemberg's and the D. And the basis,
7 Your Honor, is that with regard to the methodology
8 that was used particularly with regard to the
9 forfeiture rights, what it amounted to was a
10 series of assessments of what this witness said
11 were probabilities. There was no basis to show
12 upon what was that assessment of the probability
13 of that event occurring based. That's the first
14 part of it.

15 The second problem with it, Your
16 Honor, is as far as I know that kind of an
17 analysis has never been accepted in any court,
18 certainly not in Massachusetts, for valuing any
19 class of security - as far as I know, not anywhere
20 else. I've never seen that, and we looked; and we
21 could not find anything that would support that
22 type of analysis. Mr. Dwork has offered no basis
23 upon which to do it. It's merely - as the witness
24 said, it's on the idea of gambling. You assess a
25 series probabilities.

1 THE COURT: We'll deal with the
2 preferred D first. That doesn't involve any
3 forfeiture provisions. The comparison between the
4 preferred D and preferred C, there were no
5 considerations of forfeiture provisions with
6 respect to that analysis?

7 MR. WALSH: No, there wasn't.

8 THE COURT: Why don't we deal with
9 that first, and then I'll deal with Mr. Stenberg's
10 stock which was subject to the forfeiture
11 provisions. You're moving to strike it all?

12 MR. WALSH: That's right, all three
13 of the opinions.

14 THE COURT: What's the basis of
15 your motion to strike Mr. Romney's opinion with
16 respect to the value of Class D stock?

17 MR. WALSH: With regard to that,
18 Your Honor, in fact - although Mr. Dwork didn't
19 bring it out - the basis of that opinion is a
20 similar type of analysis. I know that because the
21 witness has been reviewing and putting this chart
22 up from Exhibit 5 from his deposition, and the
23 information was contained in that. Of course,
24 he's been deposed upon it.

25 And particularly with regard to the

1 first right under preferred C, he assessed a 50
2 sent penalty to that, Your Honor. That was based
3 upon an assessment of a series of probabilities of
4 certain events occurring particularly, whether or
5 not an event would occur, which would result in a
6 board vote to sell the company at such a low price
7 that the liquidation preference would actually
8 have any meaning - would actually come into play.
9 That was a very limited probability according to
10 the witness.

11 And what he did was evaluated - he
12 came up with the price by trying to, the discount
13 that he has in his chart, by trying to go through
14 a series of again a probability analysis of
15 whether or not this is going to occur. I believe
16 he assessed with respect to that something less
17 than a 25 percent probability that it could occur,
18 and then factored that against the price of the
19 preferred C. And that's where this number
20 actually came from.

21 And he did basically the same thing
22 with respect to each of the other rights -
23 assessed the probability that an event - for
24 example, a dividend preference - actually only
25 comes into play again in a narrow range of

1 circumstances, if the company sells at such a low
2 price that this particular right has any value to
3 it. Once again, there was an assessment of the
4 probability that that particular event is going to
5 happen; and that was factored against the price of
6 the C.

7 The redemption again was what he
8 referred to as the living dead probability, the
9 living dead company. And that was, again, an
10 assessment of what's the probability that the
11 company will come out in a very narrow range of
12 circumstances at which it's not good enough to go
13 public; it's not bad enough to liquidate. But
14 right in this narrow range of prices the company
15 would, first of all, bring that narrow range of
16 price; and secondly, would in fact have board
17 support to actually sell it.

18 THE COURT: You mean the company
19 survives but doesn't prosper indefinitely?

20 MR. WALSH: It appears to him that
21 that's what's going to happen.

22 THE COURT: If that were to
23 happen.

24 MR. WALSH: That's right. So the
25 same thing happens with the antidilution right.

1 It was a probability that anybody would do that;
2 that they, in fact, would vote it to a delusional
3 financing based upon the fact that this witness,
4 and in fact the other board members, in fact were
5 diluting themselves because they were the
6 investors in the prior rounds. Again, a system of
7 probability was made. All of that material, Your
8 Honor, appears on what I think is page three of
9 Mr. Romney's report, if we can call it that. It's
10 his handwritten notes that he prepared in
11 anticipation of testifying in this deposition.

12 THE COURT: Isn't the problem with
13 your objection this - if, in fact, none of these
14 events came about - which in fact none of them did
15 - and then the common becomes roughly equivalent
16 in value to the preferred; that is, the preferred
17 converts into common on a public offering worth
18 dollar for dollar, the common becomes worth that -
19 isn't the trouble with that and the bases of the
20 objection in September of '87 nobody knew whether
21 these contingencies were likely to arise or not?

22 And the mere existence of the
23 contingencies, whether they in fact arose or not,
24 the existence of them in September of '87,
25 effected the value of the stock to a prospective

1 purchaser at arm's length, a willing buyer, what a
2 willing buyer was willing to pay to a willing
3 seller given the disclosure of all of these
4 contingent difficulties? Although in this case
5 it's not contingent difficulties; it's contingent
6 benefits in the event of difficulties.

7 MR. WALSH: Theoretically that
8 would be true except what's happening is that the
9 witness is testifying that he's able to determine
10 to a mathematical probability whether or not any
11 one or more of those events will or will not
12 occur. And that is what I'm suggesting to the
13 Court has no support.

14 THE COURT: I don't read into his
15 testimony that he's willing to estimate, to
16 testify to a mathematical certainty an exact
17 likelihood of any event occurring. What I
18 understand and believe in the testimony - that in
19 September of '87 that preferred C stock had
20 certain benefits that the preferred D didn't. And
21 in contrasting the value of the two classes of
22 stock, one had to look at the benefits conferred
23 on the Class C stockholders that the Class D
24 stockholder did not have.

25 And therefore, an arm's length

1 buyer presumably had a right to pay less for the
2 preferred D than he or she would have for the
3 preferred C because on a down scenario or a
4 pessimistic scenario, if unhappy events
5 transpired, the preferred C would have greater
6 protection, on a down-side scenario.

7 What he's saying as I understand,
8 he's discounting the preferred D based on the fact
9 that in September of '87 nobody had a crystal
10 ball, but that those preferences existed with one
11 class of stock that didn't exist with another; and
12 that is used as the basis. I think what you're
13 addressing again goes to the weight of the
14 testimony.

15 For example, if you can demonstrate
16 that none of these so-called preferences or leg
17 up, so to speak, of the preferred C stockholders'
18 finance knowledge, none of them had any likelihood
19 in reality - that certainly goes to his
20 credibility and perhaps the weight one might
21 accord to his evaluation. I don't think it makes
22 it inadmissible simply because you disagree or are
23 unwilling to accept the probabilities he's
24 assigned. The Court hasn't necessarily adopted
25 the probability of any of these events occurring,

1 but it's not unreasonable to assume based on this
2 expert's testimony that a knowledgeable investor
3 would be willing to pay more for a preferred C
4 that had all these provisions in the event of a
5 down-side scenario than it would pay for a
6 preferred D.

7 With respect to your motion to
8 strike his testimony on the value of the preferred
9 D using the preferred C as a base line, I'm going
10 to deny the motion. I think what you're arguing
11 might go to the weight but not to the
12 admissibility.

13 MR. WALSH: It's the same argument
14 with respect to the other two.

15 THE COURT: That would be the
16 same. Although none of these events in fact did
17 occur, fortunately I suppose for everybody
18 involved, nonetheless the potentiality for them
19 occurring at least in September of '87. This
20 witness through his expertise is trying to assign
21 a discount to that eventuality which nobody knew
22 in September of '87.

23 MR. WALSH: Thank-you, Your Honor.

24 THE COURT: He certainly can
25 qualify as an expert who deals and makes decisions

1 on a regular basis on these types of
2 potentialities. I'll let his testimony stand.
3 Now, having disposed of that, you're going to be
4 required to conduct a cross-examination.

5 MR. WALSH: Thank-you, Your Honor.
6 Are we going to take a recess?

7 THE COURT: We started a little
8 late at your request, so let's skip the afternoon
9 recess.

10

11 Cross-examination:

12 Q. (By Mr. Walsh) Mr. Romney, you're a board
13 member at Staples, are you not?

14 A. Yes.

15 Q. And you've been such a member; you are
16 today and have been consistently for about four
17 years, right?

18 A. That's correct.

19 Q. And at all times you've known Mr.
20 Stenberg?

21 A. Yes.

22 Q. Have you had dinner with Mr. Stenberg?

23 A. Yes.

24 Q. Have you traveled with Mr. Stenberg?

25 A. I don't believe so.

1 Q. Did you travel to New York with Mr.
2 Stemberg to see certain investment bankers?

3 A. Yes, I did. Thank-you.

4 Q. And do you recall who the investment
5 banker was?

6 A. Let's see, I saw an investment banker at
7 Morgan Stanley, and I saw an investment banker -
8 I'm terrible with names - I believe at Kidder
9 Peabody with Mr. Stemberg.

10 Q. What about Goldman Sachs?

11 A. I don't believe I met with Goldman Sachs
12 in New York with Mr. Stemberg, but that's
13 possible.

14 Q. Have you and Mr. Stemberg discussed in the
15 course of your relationship the prospect of doing
16 other business deals together?

17 A. Yes.

18 Q. On how many occasions?

19 A. Five or six, I'd say, less than ten, more
20 than five.

21 Q. When was the first?

22 A. When you say other business deals, could
23 you clarify what you mean by that?

24 Q. Other business deals with Mr. Stemberg.

25 A. Other than Staples or Staples related?

1 Q. Other than Staples itself, the deal in
2 which you invested some amount of money that
3 you're going to tell us tomorrow?

4 A. Yes. When was the first?

5 Q. Yes.

6 A. The first would have been a discussion
7 about investing in Europe or Canada for Staples,
8 and that was probably 1987.

9 Q. When in 1987?

10 A. I don't know.

11 Q. And is it your recollection that's the
12 first time?

13 A. That was the first time that I recollect
14 discussing - doing deals with Mr. Stemberg. He
15 has referred possible investors or investments to
16 us, I believe, over time; but in terms of doing a
17 deal with Mr. Stemberg that would have been the
18 only time we would have discussed that potential.

19 Q. And when was the last time that you
20 discussed doing a business deal with Mr. Stemberg?

21 A. At lunch today.

22 Q. And at lunch today was there any
23 particular deal that the two of you were
24 discussing?

25 A. Yes.

1 Q. What was that?

2 MR. DWORK: Well, Your Honor--

3 THE COURT: It would be a waste in
4 this court.

5 MR. DWORK: I think we're probably
6 getting into an area of confidentiality. I would
7 ask that names not be required to be given.

8 THE COURT: What would be the
9 relevance of a future deal that would have
10 materialized--

11 MR. WALSH: It goes to the bias of
12 this witness. They're presently business
13 associates, not only through Staples, but in
14 addition getting themselves involved in other
15 ongoing deals.

16 MR. DWORK: I misunderstood that
17 was my brother's reason but--

18 THE COURT: It's a valid reason.
19 He can inquire as to potential bias.

20 MR. DWORK: I agree 100 percent,
21 but I feel sometimes people should be protected on
22 trade secrets or that type of thing. And it seems
23 to me he can ask about bias without getting
24 identification of who the party is.

25 THE COURT: That's a fair

1 suggestion. Is there any way to get you to have
2 your inquiry without discussing the concept or
3 identity of the deal. Because it seems to me if
4 Mr. Stenberg were hatching a new enterprise and he
5 wanted Mr. Romney and Mr. Romney alone to have
6 information about that new enterprise, he did not
7 want to disseminate it to the general public or
8 those in this room, seems to me he has a right to
9 some degree of privacy with respect to that
10 enterprise.

11 On the other hand, you can
12 certainly inquire as to whether they discussed a
13 business enterprise without identifying it.
14 Whether he committed to making an investment or
15 indicated he would consider making an investment
16 on behalf of Bain, presumably, you certainly can
17 have those kinds of questions.

18 MR. WALSH: I can certainly ask the
19 questions without getting into the trade secret.
20 We need some identification of the nature of the
21 deal. I would remind the Court that everything in
22 this case is impounded anyway and already has
23 been.

24 THE COURT: The documents are
25 impounded but--

1 MR. WALSH: Counsel has been
2 instructed not to speak with the press or
3 anything, and we so agreed.

4 MR. DWORK: We have in this room
5 Mr. Beach who is, in fact, an appraiser; and I
6 don't know what his relationship is in the
7 community or who he has a relationship with. I
8 don't think the names of possible deals ought to
9 be disclosed. If my brother wants to find out
10 whether a deal is cooking and even the monies
11 involved, I have no objection.

12 MR. WALSH: We'll call this one
13 deal X.

14 THE COURT: Fine. You have every
15 right to inquire, but why don't you see if you can
16 do it in a way that won't infringe on any new
17 concepts in terms of disclosing (a) the concept or
18 (b) the location of the concept. But you can
19 certainly ask him whether a deal was discussed,
20 whether or not he's anxious to participate,
21 whether he reviewed any documents, things of that
22 nature.

23 Q. Within the constraints the Court has set
24 out, sir, would you describe the transaction that
25 you discussed most recently with Mr. Stemberg -

1 and if we can call that transaction just X?

2 A. It, like all of the other transactions or
3 deals which have been discussed between Mr.
4 Stemberg and myself, related to the interests of
5 the corporation in establishing businesses which
6 would be affiliated with the corporation.

7 Q. That is Staples?

8 A. That is Staples. And have been discussed
9 at length with the executive committee and the
10 board of the company. So the deals that have
11 involved Tom and me have been considered only in
12 the speculative light as to would we be
13 potentially willing to invest or help him think
14 about a deal where the company could begin another
15 affiliated company in which Tom would play a key
16 role. There have been no deals of any nature
17 where Tom and I would be involved I as an investor
18 and he in whatever role other than those relating
19 to the business of the company.

20 So specifically deal X, we're
21 considering options to open in new markets where
22 Staples does not now participate and wondering and
23 exploring together would these be set up as
24 separate companies partially owned by Staples or
25 wholely owned by Staples, and we exchanged

1 viewpoints on that issue and how to describe
2 that. To respond to your question, that is in
3 effect a deal discussed between Tom and me that
4 would involve both of us, I as an investor and Tom
5 as the CEO.

6 Q. How about private transactions between you
7 and Mr. Stemberg, have you discussed Mr. Romney as
8 opposed to Bain Capital?

9 A. No.

10 THE COURT: As a general partner of
11 Bain Capital are you prohibited from personally
12 investing in the vehicles that you select for Bain
13 Capital?

14 THE WITNESS: Actually we are
15 required currently to invest seven-and-a-half
16 percent of the capital Bain puts in. We must put
17 in our own money at the same time the fund puts
18 in.

19 THE COURT: You're required to put
20 in seven-and-a-half percent of your own--

21 THE WITNESS: If Bain Capital
22 invests a million dollars in a transaction, we are
23 required to invest \$75,000 personally in the same
24 transaction. There are ten general partners. We
25 must put in \$75,000 for each million dollars of

1 the this to assure that we really believe it's a
2 good deal.

3 THE COURT: Are you prohibited from
4 investing more than --

5 THE WITNESS: Yes, more than
6 seven-and-a-half percent we may not.

7 THE COURT: Or less?

8 THE WITNESS: Less than
9 seven-and-a-half percent unless the investment
10 becomes very very large which would be prohibitive
11 for us. We also are prohibited from investing
12 personally in a deal that would be of interest to
13 the fund. We cannot take--

14 THE COURT: Can't divert an
15 opportunity?

16 THE WITNESS: Can't divert an
17 opportunity.

18 Q. Would you explain please, sir, first of
19 all, how many times have you and Mr. Stemberg
20 discussed deals like the X deal which would
21 involve some affiliation with Staples?

22 A. Five or ten times.

23 Q. And how many of those times did a deal
24 actually come together?

25 A. None that involved us.

1 Q. None yet. With regard to your pay
2 structure for your investment in Staples, sir,
3 would you explain to the Court please how it is
4 that you, Mitt Romney, gets paid for your
5 investment in Staples?

6 A. Currently or at the time the investment
7 was made?

8 Q. At the time of the investment with regard
9 to each of the rounds, if it changed?

10 THE COURT: Run that by me again?

11 MR. WALSH: How Mitt Romney gets
12 compensated for investment in each of these
13 rounds.

14 THE COURT: How he personally?

15 MR. WALSH: Yes.

16 A. I am paid a salary as part of my
17 compensation, which is paid to me by my
18 investors. My investment pool for Bain Capital
19 fund or the first fund, we receive a management
20 fee of two-and-a-half percent meaning
21 two-and-a-half percent times \$37 million a year is
22 paid to us as a management group. We have
23 currently 18 employees including myself, ten
24 partners, and we are paid from this management fee
25 a salary. In addition we receive - collectively

1 our group receives a certain percentage of the
2 profit which we create for our investors on our
3 total investment pool.

4 So we take our profits that we
5 create for them, take away our losses that we cost
6 them; and if there is a profit left over, we as a
7 group receive a certain percentage of that. And
8 in the fund that we're discussing we as a group
9 received ten percent of the total profits which we
10 generated net of the losses for our investors.

11 THE COURT: That's outside of the
12 management fee, in addition?

13 THE WITNESS: That's correct.

14 THE COURT: Two-and-a-half percent
15 of the funds invested and ten percent of the net
16 profits?

17 THE WITNESS: Two-and-a-half
18 percent of the funds committed and then ten
19 percent of profits, net profits realized.

20 Q. And when you referred to the total
21 balance, that would be all the investments during
22 that specific period of time in that particular
23 fund, right?

24 A. Made by that fund.

25 Q. With respect to Staples what proportion,

1 if you know, of the overall management funds did
2 the investment in Staples represent in 1986, if
3 you know that?

4 THE COURT: You mean the Class A?

5 Q. Yes, at the time of the Class A.

6 A. At the time of the Class A it would have
7 represented--

8 THE COURT: I don't think we know
9 what funds were committed. He wasn't sure about--

10 MR. WALSH: That's why I asked if
11 you know.

12 A. It's less than two-and-a-half percent of
13 our total fund at that point.

14 Q. Now, when you spoke before about owning
15 common stock and your company occasionally buying
16 common stock in this particular instance, sir, did
17 you acquire any common stock in Staples?

18 A. No.

19 Q. Did you acquire any option to acquire
20 stock in Staples?

21 A. Yes.

22 Q. And when were you granted that option?

23 A. Let's see, I believe we were granted
24 options at the time of the formation of the
25 company in exchange for providing bridge capital,

1 meaning capital before the final closing of the
2 company. But my recollection is fuzzy there.

3 Q. And thereafter did you continue to receive
4 options?

5 A. No - excuse me, as a fund we did not
6 receive options. As a director personally I
7 received options as a director of the board.

8 Q. And that was to you personally, right?

9 A. That's correct.

10 Q. When did that occur?

11 A. Over time - and I'd have to refer to board
12 minutes as to the specific time that options were
13 granted - but presumably sometime in 1986 we
14 received board options. And then most recently I
15 think in the most recent shareholder meeting held
16 yesterday board members were authorized certain
17 options, and those vest over time.

18 Q. Irrespective of most recently, go back to
19 the time in '86 and '87. During that period of
20 time what options were granted to you? What was
21 the total amount granted to you individually?

22 A. I believe the total amount is 13,333
23 shares, and that's after the three for one split
24 of shares which - or combination of shares which
25 occurred immediately prior to the company's going

1 public. So in today's number of shares the
2 options I had was 13,333. If you go back to the
3 old shares, that's three times that.

4 Q. So that would be about 40,000 shares?

5 A. That's correct.

6 Q. And that was acquired over a two-year
7 period of time, correct, approximately?

8 A. I believe that the vesting period was
9 longer than that.

10 Q. Was it all acquired at a single time, or
11 was it in different installments?

12 A. It vested over time.

13 THE COURT: Were these your own
14 stock options as a member of the board?

15 THE WITNESS: These were my own
16 stock options as a member of the board.

17 Q. So that would be worth approximately - did
18 you exercise all of those options?

19 A. Let's see, I don't know what their status
20 is currently, whether they've been exercised; but
21 I believe they've all been exercised.

22 Q. And was that all done at the time of the
23 IPO approximately?

24 A. I just don't know as to when they were
25 exercised. I'm not sure when it was done, but I

1 do have 13,333 shares.

2 Q. When you received the options did you
3 report any income tax to the IRS for receiving
4 them?

5 A. I'm confident I complied with the
6 requirements of the IRS, but I don't recall what
7 sort of requirement--

8 Q. Well, was it your understanding--

9 THE COURT: Did you expect another
10 answer to that question?

11 Q. I hope not. Was it your understanding
12 that when you received those options, that there
13 was taxable income to you as a result of the
14 receipt of the options?

15 A. I presume there is, and I'm sure - I
16 presume there was at the time, and followed
17 whatever filing procedures were required.

18 Q. Do you recall filing a return basically
19 reporting income of what was the then board set
20 value on those options?

21 A. Sorry, I don't--

22 Q. Do you recall that that was the
23 methodology at least you used? Irrespective of
24 whether you remember the number, was that the
25 basis upon which you reported the income?

1 A. It may have been, but I don't recall.

2 Q. Do you remember a board discussion about
3 these options and the taxability of the mere
4 declaration of the option?

5 A. We've had a number of discussions as a
6 board about options, the taxability, the reported
7 or the effect of an earnings of options on various
8 qualified and non-qualified option programs, yes.
9 We've discussed option values and had in various
10 board meetings assessed values associated with the
11 options.

12 Q. If I understand your work here, you're
13 saying to His Honor that the common stock is worth
14 - forgetting Mr. Stemberg's restrictions for a
15 moment - and by the way, Mr. Stemberg's stock and
16 common stock are, in fact a single class, right?
17 They are not two different classes?

18 A. That's correct.

19 Q. So Mr. Stemberg has the same common stock
20 that everybody else has, right?

21 A. I believe that's correct.

22 Q. Except in his case they're also subject to
23 certain contractual obligations?

24 A. Yes.

25 Q. With regard to the common stock then, the

1 price that you came up with for the common stock I
2 think was between \$1.10 and \$1.50; is that right?

3 A. That's correct.

4 Q. For the sake of convenience can we call
5 that \$1.30, a midpoint?

6 A. Fine.

7 Q. \$1.30 is your opinion, if I understand
8 your testimony, as to the value of the common on
9 or about September, 1987; is that correct?

10 A. That's correct.

11 Q. And you were a member of the board at that
12 time?

13 A. That's correct.

14 Q. In fact, on September 22 you attended a
15 board meeting of Staples, didn't you?

16 A. That's correct.

17 Q. In that particular meeting two of the
18 subjects that came up in that meeting were the
19 approval of the issuance of the Class C and the
20 approval of the issuance of the Class D, correct?

21 A. Yes.

22 Q. And you voted--

23 THE COURT: Excuse me, the date of
24 that meeting?

25 MR. WALSH: September 22, Your

1 Honor.

2 And you voted in favor of both of
3 those propositions, didn't you?

4 A. That's correct.

5 Q. And in addition another subject that came
6 up at the board meeting was the discussion about
7 issuance of some more options to different
8 individuals, wasn't there?

9 A. I do not recollect that, but it would not
10 surprise me at all.

11 Q. Well, do you recall that at that board
12 meeting there was a discussion with regard to the
13 fair market value of the common stock?

14 A. Again, I don't doubt that that was
15 discussed at that meeting because we've had many
16 meetings and discussed option values at many
17 meetings. Whether it was that specific meeting or
18 not, it's hard for me to recollect; but I have no
19 memory to the contrary.

20 Q. In any case, sir, do you recall a
21 discussion at approximately that point in time at
22 the board level about valuing common stock at
23 about .001 cent per share?

24 A. I believe that the valuation at that time
25 was approximately 25 cents a share.

1 Q. That's your recollection in September?

2 A. It's very hard for me to pick a specific
3 time, but I thought on or around the time of the
4 preferred C that the value was approximately 25
5 cents a share. But I knew for a long period of
6 time it was the small number that you just
7 indicated - what was it - .001. My ability to
8 pick the specific date that we changed the
9 valuation of the common is not very great, but I
10 would trust the board minutes as to when we
11 changed the valuation of the common as reported.

12 MR. WALSH: Let me show you, sir,
13 what I believe has already been put in evidence as
14 an exhibit, the minutes of the board meeting of
15 September 22, '87. I do not recall the exhibit
16 number. I don't have it on this particular
17 document.

18 THE COURT: Put it through Mr.
19 Goodman or premarked?

20 MR. WALSH: They were premarked,
21 and I believe we had agreed to put them in, Your
22 Honor, with respect to '87--

23 A. Yes, as of that date looking at these
24 minutes the value was determined at .001 dollar
25 per share or one-tenth of one cent per share.

1 Q. Do you remember any discussion at the
2 board meeting about that?

3 A. Yes, at each board meeting where we
4 assessed the valuation of the common stock we
5 talked about what was the difference in value
6 between the common and preferred stock, and did
7 the condition of the company justify the
8 significant difference in valuation which we had
9 set.

10 Q. And with respect to the price of .001
11 cent--

12 THE COURT: .001 dollar is what he
13 testified to.

14 MR. WALSH: So it says, that's so.

15 THE COURT: Exhibit 129, is that
16 not the exhibit?

17 MR. WALSH: I believe so.

18 THE COURT: Agreed on a value of
19 .001 dollar, which translates to one-tenth of a
20 cent.

21 Q. One-tenth of a cent?

22 A. Correct.

23 Q. And you voted in favor of that, did you
24 not?

25 A. As best I recollect, yes.

1 Q. But you're telling the Court that the
2 common stock on that date was really worth
3 something about \$1.30?

4 A. That's correct.

5 Q. On the same day?

6 A. That's correct.

7 Q. Now, was it your true belief when you
8 voted on September 22 that the value of the stock
9 was a tenth of a cent?

10 A. It was my true belief that one could
11 justify one-tenth of one cent as the value of the
12 common stock, but that the stock was probably
13 worth more than that.

14 Q. Mr. Romney, it's a simple question.
15 You're a lawyer, are you not?

16 A. I went to law school, but I'm not a
17 lawyer.

18 Q. The question was - was it your true
19 belief--

20 THE COURT: He's not too unhappy
21 about that either.

22 MR. WALSH: I think we both made
23 mistakes.

24 Mr. Romney, was it your true belief
25 at this board meeting when you voted for this

1 price for the common, that that was indeed the
2 value of the common?

3 A. Yes, at that time.

4 THE COURT: Talking about fair
5 market value?

6 Q. Fair market value of the common.

7 A. Of the common at that time, yes.

8 Q. That was your belief?

9 A. Yes.

10 Q. But now your belief is that the fair
11 market value of the common is \$1.30?

12 A. Yes.

13 Q. By the way, did you take a look at your
14 deposition before you testified on direct?

15 A. I did take a look at it, but I did not
16 read it.

17 Q. You did not read it?

18 A. No.

19 Q. When was the last time you did read it?

20 A. I haven't read my deposition.

21 Q. Ever?

22 A. No, I have not read my entire deposition.
23 I read some portions of the pages, but I did not
24 read through the deposition.

25 Q. Which portions did you choose to read?

1 A. I read only portions of the first
2 deposition, whatever date that was, and I read
3 portions which - I have an underlined copy. I
4 received underlinings from the counsel for Mr.
5 Stemberg and their notes, and I looked at those
6 and some of those, not all of them.

7 Q. Do you have that copy of the transcript?

8 A. Yes.

9 Q. And you have it with you?

10 A. Yes.

11 Q. And you particularly read the ones that
12 were underlined; is that right?

13 A. That's right.

14 Q. And with respect to your vote, sir, is it
15 your understanding, sir, that by coming here today
16 and testifying that the common was worth \$1.30 in
17 September, '87, but that the board had voted and
18 you voted to set the price at .001 dollar a share
19 in September of '87; and by so doing you're in any
20 way violating any fiduciary duty to your company?

21 A. I don't believe so, but I don't --

22 Q. Did anybody ever tell you you were?

23 A. I don't think--

24 MR. DWORK: Other than his counsel,
25 Your Honor.

1 MR. WALSH: Other than his
2 counsel.

3 A. I don't think I have any duty of a
4 fiduciary nature to tell me to say anything other
5 than the truth, to coming in and telling you
6 exactly what I believe the value of the common
7 shares were. I don't think anybody would--

8 Q. You'd be surprised if somebody made such a
9 suggestion, wouldn't you?

10 A. Yes.

11 Q. Did Mr. Stenberg come to you, sir, in 1987
12 and ask you whether or not he could set a value on
13 the common stock?

14 A. I don't believe so - I don't believe so,
15 no.

16 Q. Did he ever discuss with you in 1987
17 whether or not if he were to state a value for his
18 common stock, that by so doing he would or might
19 be in violation of a duty to his board or to his
20 company?

21 A. No, I don't believe so.

22 Q. Did he ever ask permission from you in
23 discussions with you for leave to state a value of
24 the common stock to any third person?

25 A. Yes, we voted on a value of the common

1 stock, and that was communicated to the employees
2 and to the outside.

3 Q. Other than the board set price did he ever
4 ask you whether or not he could - ask or discuss
5 with you whether or not he could set a price for
6 what he believed his common to be worth and tell
7 it to some third person?

8 THE COURT: You mean set a price
9 other than what the board had determined; is that
10 what you're asking?

11 MR. WALSH: Yes.

12 THE COURT: Do you understand the
13 question?

14 A. Yes, I do. And it's - revolving at the
15 time we discussed the transfer to his former
16 spouse of shares, that may have been discussed. I
17 don't recall it specifically, but we may have
18 discussed a whole series of ways of accomplishing
19 the division that was required.

20 Q. That's the division of the stock. I'm
21 talking about the value of the stock. Did he ever
22 come to a board of directors meeting in '87 and
23 ask leave of the board of directors to be
24 permitted to state to his wife what he believed
25 the value of the common stock to be?

1 A. I don't recall that, sorry.

2 Q. Did he ever come to you or come to the
3 board in '87 and seek leave to state a value for
4 the common stock that he held to a man named Frank
5 Levy?

6 A. No, not that I can recall.

7 Q. Do you know who Frank Levy is?

8 A. Sorry, I don't.

9 Q. Do you recall any occasion where Mr.
10 Stemberg came to the board of directors and asked
11 for leave to give to either his wife or somebody
12 named Levy or at least his wife's attorney
13 financial information concerning the company?

14 A. At the time of the preferred D conversion
15 we had a discussion about the information rights
16 or the right of financial information that would
17 be associated with preferred D and with his wife
18 and with the transferees and interests of
19 preferred D and the needs for those preferred
20 shareholders of financial interest of the company.

21 Q. How about before that - how about back in
22 April of '87?

23 A. I don't recall such discussions prior to
24 the time of the preferred D discussion.

25 Q. So you have no recollection of such a

1 request at any time before the time the D was
2 created of a request by Mr. Stemberg in effect
3 asking for leave to provide financial information
4 concerning Staples to Mrs. Stemberg?

5 A. That's correct.

6 Q. Or to Mr. Levy?

7 A. That's correct.

8 Q. Or to any person that was identified to
9 the board as being the attorney or other
10 assistant, whether it be an attorney or somebody
11 else who might be advising Mrs. Stemberg; is that
12 true?

13 A. That's correct.

14 Q. You testified on direct that your hurdle
15 rate is 58.5 percent?

16 A. That's correct.

17 Q. At the time of the round C?

18 THE COURT: Hurdle rate for round A
19 financing?

20 Q. That's right. And that is your general
21 rate, is it not, 58.5 percent for your
22 investments?

23 A. Well, yes and no. That's our rate for
24 investments in startup companies. For our
25 investments in less risky settings we take a lower

1 rate of return. For instance, if we're acquiring
2 shares in a company which has made further
3 progress and looks like it's a relatively low risk
4 situation, we will invest at a rate of return
5 which is substantially less than that although
6 still usurious.

7 Q. And in fact, sir, that's typical, is it
8 not, that the hurdle rate for an investment goes
9 down as the risk goes down?

10 A. That's correct.

11 Q. And in this particular case, sir, at the
12 time you invested in the A, I believe you told His
13 Honor that you vested on the basis of the 58.5
14 percent rate of return?

15 A. Yes.

16 Q. And the same with respect to the round B?

17 A. The rate of return we were looking for in
18 round B would have been marginally less.

19 Q. But still basically around the 58 percent
20 rate?

21 A. That's correct.

22 Q. By the time you got to the round C in
23 September of '87, your rate was much less, wasn't
24 it?

25 A. Would have dropped into the 40s.

1 Q. It was approximately 40 percent, was it
2 not?

3 A. That's in the realm of what I would
4 consider, yes.

5 Q. That's what you told me under oath in your
6 deposition, isn't it?

7 A. You have the deposition. That's totally
8 consistent with what I believe I've just said.

9 Q. So at that point in time, sir, you felt
10 that the investment in Staples was a good deal
11 less risky than it had been some nine months
12 before January of '87, right?

13 A. That's correct.

14 Q. And that was based upon your experience
15 with the company at that time, is it not?

16 A. That's correct.

17 Q. You had been pretty intimately involved
18 with this company during those nine or ten months,
19 hadn't you?

20 A. Yes.

21 Q. You had gone to a number of board meetings
22 during that period of time?

23 A. Yes.

24 Q. You had met with investors, had you not?

25 A. Yes.

1 Q. Potential or otherwise. And as a matter
2 of fact, you were a member of sort of a
3 subcommittee of the board, were you not?

4 A. That's correct.

5 Q. And the subcommittee was titled what?

6 A. We had an executive committee. We also
7 had a growth committee. We had a compensation
8 committee - all three of which I served on. I
9 don't recall when each was commenced, but I do
10 serve and have served on all three.

11 Q. And in the period 1987 did all three such
12 boards exist?

13 A. Sorry, I don't recall.

14 Q. It is fair to say, is it not, at least the
15 executive committee existed in that year?

16 A. Yes.

17 Q. And the compensation committee existed in
18 that year, didn't it?

19 A. Yes.

20 Q. And you were a member of both of those?

21 A. Yes.

22 Q. And a second member of both of those was
23 Tom Stemberg, right?

24 A. That's correct.

25 Q. And a third member of the executive

1 committee was David Leobruno, wasn't it?

2 A. I don't believe so.

3 Q. Who was it?

4 A. Leo Kahn and Sammy Samuels were the other
5 two members of the executive committee to the best
6 of my recollection; but again, the company's
7 documents would clarify that.

8 Q. Who was the other member of the
9 compensation committee in '87?

10 A. I believe it would be Dave Leobruno and
11 myself; but again, as to '87 who would be on the
12 compensation committee I'm not 100 percent sure.

13 Q. In any case you attended the meetings, and
14 did you also during that period of time have
15 occasion to visit the offices of Donaldson Lufkin
16 in New York concerning Staples?

17 A. I don't believe so.

18 Q. Not in 1987?

19 A. I don't believe I've ever visited the
20 offices of Donaldson Lufkin and Jeanerette.

21 Q. By the way, do you know a man named
22 Meadow?

23 A. Scott Meadow, yes.

24 Q. Who is he?

25 A. Scott Meadow is a partner, general

1 partner, of a fund in Chicago called the William
2 Blair Venture Capital Fund.

3 Q. And how long - is it Meadow or Med-ow?

4 A. M E A D O W.

5 Q. Just like the field?

6 A. Just like the field.

7 THE COURT: General partner of --

8 THE WITNESS: Of William Blair

9 Venture Partners from Chicago.

10 Q. And how long have you known him?

11 A. I think since about 1986 or '87.

12 Q. And in 1987 did you speak to him about
13 Staples?

14 A. Yes.

15 Q. When in 1987?

16 A. I don't recall, but it was associated with
17 him potentially being an investor in one of the
18 two rounds that occurred in 1987 of investment,
19 either B or C. I don't recall which of the rounds
20 he invested in Staples; but whichever one it was,
21 he called me as I recollect and discussed the
22 company with me and the potential interest of
23 investing in the company. My recollection is he
24 came in on B, but it could have been C. I don't
25 recall.

1 Q. You don't recall?

2 A. No.

3 THE COURT: Would he be considered
4 the competition or not in this venture capital --

5 THE WITNESS: Yes, competition
6 sometimes, but friends on others.

7 THE COURT: From your testimony
8 prior it seems like general partners of these
9 various venture capital firms confer with one
10 another with respect to the same investment?

11 THE WITNESS: That's correct. At
12 the stage where he was a potential investor in
13 Staples, it would have been in my interest to have
14 him want to invest in Staples alongside me as I
15 described before. I didn't want to have to put in
16 all the money needed. I wanted to see other
17 venture capitalists come in.

18 THE COURT: You were looking for
19 company?

20 THE WITNESS: Yes. And it was in
21 that context that he talked to me to find out
22 whether this was a good company to invest in or
23 not.

24 Q. Was that in approximately September 1st,
25 sir, '87?

1 A. I indicated that my memory really is
2 insufficient to tell you when it was that I talked
3 to Scott about their investment in Staples, but it
4 was immediately prior to their decision to make an
5 investment. If they joined Staples as an investor
6 in round C, it would have been roughly in the
7 September time period.

8 Q. And sometime before the round C was, in
9 fact, authorized by the board, right?

10 A. Yes.

11 MR. WALSH: Your Honor, I noticed
12 it's a little after four--

13 THE COURT: We can suspend. I'd
14 like to finish up with this witness tomorrow.

15 MR. WALSH: I think we'll finish
16 tomorrow.

17 THE COURT: How much time without--

18 MR. WALSH: I would guess I would
19 have approximately three hours, would be my best
20 guess.

21 MR. DWORK: That means nine hours.

22 MR. WALSH: No, my estimates are
23 accurate.

24 THE COURT: Another 15 minutes and
25 we'll stop.

1 Q. With respect to Mr. Meadow, sir, did you
2 speak to him concerning Sears in September of '87?

3 A. I don't recall specifically the discussion
4 I had with him with regards to his interest in
5 investing in Staples, but that would be logical
6 for me to discuss that with him if discussions
7 with Sears had started by that time period. I
8 don't recall the specific discussions I've had
9 with Mr. Meadow, but I would surely describe for
10 him everything I knew positive about the company
11 and any major issues I knew negative about the
12 company. And if the Sears discussions had begun
13 at that time, I would definitely acquaint him with
14 that fact.

15 Q. You would consider that a positive
16 development, right?

17 A. Yes.

18 Q. And you'd want him to be informed of that
19 fact, wouldn't you?

20 A. That's correct.

21 Q. That might influence his thinking as to
22 whether or not Staples is a good company to invest
23 in or not; is that right?

24 A. That's correct.

25 MR. DWORCK: Could I have a moment

1 to discuss with your witness--

2 (Witness and counsel confer.)

3 THE COURT: We'll suspend.

4 (Whereupon, adjourned at 4:05 p.m.)

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CERTIFICATE

Commonwealth of Massachusetts
Middlesex ss.

I, Katherine G. Henry, a Notary
Public and Registered Professional Reporter, do
hereby certify that the foregoing record, pages
2732 through 2892, inclusive, is a complete,
accurate and true transcription of my stenographic
notes taken in the aforementioned matter to the
best of my skills and ability.



Katherine G. Henry

My Notary Public expires:
April 23, 1993

Part II

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VOL. XX
PAGES 2893 - 3084
EXHIBITS L

COMMONWEALTH OF MASSACHUSETTS

NORFOLK, ss.

PROBATE & FAMILY COURT
No. 87D-802-D1

THOMAS STEMBERG,)

Plaintiff,)

vs)

MAUREEN SULLIVAN-STEMBERG,)

Defendant.)

MAUREEN SULLIVAN-STEMBERG,)

Plaintiff,)

vs)

THOMAS G. STEMBERG,)

Defendant.)

Norfolk Complaint
in Equity for
Rescission of
Agreement
No. 90E-0056

BEFORE:

David H. Kopelman, J.

Dedham Probate & Family Court
Dedham, Massachusetts
Thursday, July 27 1991
Commencing at 10:38 a.m.

MAHANEY REPORTING SERVICES
Tel. (617) 542-4207

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14 Stemberg.

10

I N D E X

11

12 Witnesses:

13 Willard Mitt Romney

Direct/
Redirect

2895

Cross/
Recross

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15 Exhibits
For Iden.

16 L Handwritten note

Page

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1 THE COURT: For the record this is
2 the case of Maureen Stemberg vs. Thomas Stemberg
3 docket No. 90E-0056 and 87D-802-D1. This is a
4 complaint in equity to rescind the separation
5 agreement and a motion to vacate that portion of
6 the divorce judgment dealing with the separation
7 agreement. In attendance today are Attorneys
8 Joeseeph Walsh and Scott Liebert representing Mrs.
9 Stemberg and Attorneys Bernard Dwork and Enid
10 Starr representing Mr. Stemberg.

11 Now, are you going to finish your
12 direct?

13 MR. DWORK: Yes, Your Honor.

14 THE COURT: So this will be the
15 resumed direct examination of Willard Mitt Romney
16 whose testimony commenced yesterday. For the
17 record this witness has been previously sworn.
18 I'll remind your you're still under oath. All
19 right, Mr. Dwork.

20

21 DIRECT EXAMINATION, RESUMED

22

23 Q. (By Mr. Dwork) Mr. Romney, as a result of
24 my request did you last night determine what
25 stocks were purchased by Bain in the three rounds?

1 A. Yes, I did.

2 Q. If we can go to round A, can you tell us
3 what the total amount of the round was?

4 A. Yes, \$4,425,000 were raised.

5 Q. And that was at 80 cents a share?

6 A. That was at 80 cents a share.

7 Q. Do you have the total number of shares?

8 A. You have my notes on that if you'll send
9 that to me.

10 THE COURT: Did you say \$4,425,000?

11 A. Yes, that's correct. And the total number
12 of shares were 1,843,750 shares.

13 Q. And Bain invested how much?

14 A. \$850,000.

15 Q. And received how many shares?

16 A. And received, if you'll let me add that
17 up, received 312,500 shares.

18 Q. Now, if we go to Class B, was that an
19 offering to the holders of the Class A?

20 A. That was an offering --

21 MR. WALSH: Excuse me, Your Honor.
22 Is the math on that correct in that \$850,000 at 80
23 cents a share?

24 THE COURT: If they received
25 300 --

1 A. I'm sorry, these shares have been adjusted
2 for the one-for-three stock split. So you'll need
3 to multiply the share number by three to get the
4 original shares purchased. If you understand
5 my --

6 THE COURT: So adjusted for a
7 three-to-one reverse split?

8 A. That's correct. So it would be as of the
9 shares, of the time when these shares were
10 actually purchased. It would take the number I
11 used which was 312,500 multiplied by three to get
12 the shares which were issued to us at that point
13 which were subsequently traded three for one.

14 Q. Would that also be true for the total
15 number that were issued in Class A that you
16 multiply the figure you gave us by three?

17 A. That's correct. All of the share numbers
18 which I used were based upon the shares following
19 the three-to-one stock conversion.

20 Q. Well, we're going to talk about B and C
21 and to the extent that you can use presplit
22 dollars and numbers it will be better.

23 THE COURT: But the dollars are the
24 same?

25 A. The dollars are the same, yes.

1 Q. With respect to the B offering, was that
2 an offering made to the holders of the A shares?

3 A. It was an offering made to anyone willing
4 to invest in the company and included the
5 investors in the A shares.

6 Q. And what was the total number of dollars
7 garnished from that offering?

8 A. The total offering was for \$13,000,927.

9 Q. Do you have a record as to how many shares
10 that would be?

11 A. Yes, the number of shares, and I'm going
12 to take the number I have and multiply it by
13 three, the number of shares at that time was
14 6,632,010 shares.

15 Q. And Bain invested how much?

16 A. Bain invested \$750,000.

17 Q. And that represented what in shares?

18 A. 357,141 shares.

19 THE COURT: Post-split,
20 post-reversed split, after the reverse split?

21 A. No, that's before the reverse split. I'm
22 now moving to the conversion of the shares as of
23 the time of the offering.

24 Q. Now, sir, at that time did Bain have the
25 opportunity under its rights under the Class A to

1 purchase more than the \$750,000?

2 A. Yes, it did.

3 Q. Can you help us as to what percentage of
4 the stock which was offered to Bain Bain actually
5 purchased?

6 A. Bain purchased 55.8 percent of the stock
7 we had the right to purchase by virtue of our
8 preemptive rights. We, in fact, could have
9 purchased even more than that had we wished to.
10 But our preemptive right allowed us to purchase a
11 total of \$1,344,086 worth of stock and we
12 purchased only \$750,000 worth of stock or some
13 55.8 percent of what we had the preemptive right
14 to acquire.

15 THE COURT: What amount of funds
16 did you have the right to put in?

17 A. \$1,344,086 by virtue of our preemptive
18 right. We also had something which is referred to
19 as an over-allotment right which is if other
20 investors like ourselves did not exercise their
21 full preemptive right we had the right of
22 preemption on that extra amount left over. If
23 there was an amount left over my records don't
24 show nor do the company's so far as I know. But
25 we didn't exercise our full preemptive right.

1 Therefore, we exercised none of our allotment
2 right and; therefore, we could have invested even
3 more of either amount had we wished to because the
4 company was looking for money and anyone with a
5 large checkbook was welcome to make the
6 investment.

7 Q. With respect to the Class C shares, did
8 Bain purchase Class C?

9 A. Yes, we did.

10 Q. Can you tell us again in presplit dollars
11 and amounts what was done in dollars and amounts
12 of shares for the whole offering?

13 A. Yes, the size of the offering was
14 \$13,597,000 and the number of shares was 4,688,667
15 shares.

16 Q. Is it fair to say that the C offering was
17 done in two roll-overs if you will?

18 A. The C offering I've just described to you
19 was the C offering which closed in December of
20 1987. There was a subsequent offering of C shares
21 as well which occurred on September 15th, 1988 for
22 a lesser amount. I have not given you the
23 specifics on that offering. I'll call that, if
24 you will, the second closing of a C offering.

25 Q. And can you give us the statistics on

1 that?

2 A. Yes. The C offering which closed on
3 September 15th, 1988 was for a total of \$2,800,000
4 and the total number of shares was 799,956 shares.

5 Q. How have you broken up your purchases as
6 far as records are concerned by combining the two
7 or just doing each one?

8 A. I looked at them separately.

9 Q. Let's look at C1.

10 A. C1 which refers to the C which closed in
11 December of 1987 we invested \$763,999.20.

12 Our --

13 THE COURT: You couldn't go that
14 extra 80 cents.

15 A. Our preemptive right would have allowed us
16 to invest \$1,062,585.

17 THE COURT: I'm sorry,

18 1,062,000 --

19 A. 585. So we purchased 71.9 percent of the
20 amount our preemptive right would have provided
21 us.

22 THE COURT: Can I have that
23 percentage again?

24 A. 71.9 percent.

25 Q. Can I impose upon you to do the

1 mathematics as to the number of shares that
2 represents?

3 A. Yes. The number of shares, we acquired
4 263,448 shares.

5 Q. Out of a possibility of? *

6 A. I believe I already gave you the total
7 number of shares.

8 Q. That you could have bought?

9 A. Oh, that we could have bought?

10 Q. Yes.

11 A. We could have bought approximately 366,409
12 shares.

13 Q. And on the C2 round, can you give us the
14 statistics on that?

15 A. Yes, on the C2 round the amount which we
16 invested was \$61,383.

17 THE COURT: 61,000 --

18 A. \$61,383. And as I mentioned already,
19 there was a total of \$2,800,000 raised. We had a
20 preemptive right --

21 THE COURT: 2,800,000 was raised?

22 A. Right. And we had a preemptive right to
23 invest \$252,294. And we, therefore, invested
24 approximately 29.9 percent of our preemptive
25 right.

1 Q. Just to complete the mathematics can you
2 relate that to shares?

3 A. Yes. The number of shares, we acquired
4 17,538 shares and our preemptive right would have
5 been to acquire approximately 58,656 shares.

6 MR. DWORK: And you may resume your
7 cross-examination, Mr. Walsh.

8 MR. WALSH: Thank you, Mr. Dwork.

9
10 CROSS-EXAMINATION, RESUMED

11
12 Q. (By Mr. Walsh) Mr. Romney, yesterday I
13 asked you if you had a chance to review your
14 deposition and you indicated that you read parts
15 of it. In fact, parts I believe you told me had
16 been underlined by counsel. Since that time have
17 you reread the deposition in its entirety?

18 A. No.

19 Q. And did you read any of your deposition
20 last night?

21 A. Yes. Excuse me, not last night.

22 Q. Well, some time between the end of trial
23 yesterday and this morning?

24 A. Yes, this morning I opened the deposition
25 record from my second deposition which I had not

1 looked at prior to yesterday's session. I was
2 waiting at the coffee shop for counsel to arrive
3 and read through pages of the second deposition.

4 Q. And is there anything you want to change
5 from your testimony of yesterday having now looked
6 at the depositions?

7 A. No.

8 Q. Yesterday when we, shortly before we broke
9 we were discussing about requests, if any, made by
10 Mr. Stemberg to the board for leave to state a
11 value of his common stock to his wife and I
12 believe you told us that there had been no such
13 request to your knowledge, none that you could
14 recall?

15 A. There was none that I could recall.

16 Q. You did indicate however that at one time
17 with respect to a request or discussion concerning
18 disclosure of financial information concerning
19 Staples that you seemed to have a memory that
20 there was such a discussion about right to access
21 of financial information that Mrs. Stemberg might
22 acquire as a result of her receipt of Class D
23 stock, is that correct?

24 A. That's right.

25 Q. And it was at that time, was it not, sir,

1 that that discussion occurred, namely, at
2 approximately the time when the D was being
3 created?

4 A. That's correct.

5 Q. And so then prior to September of 1987
6 there was no request of the board by Mr. Stemberg
7 for leave to disclose financial information
8 concerning Staples, was there?

9 A. That I recall.

10 Q. Yes, none that you recall?

11 A. I don't recall any but there may well have
12 been.

13 Q. When you say "may well have been," you
14 have no recollection of such a request, do you,
15 sir?

16 A. I have no recollection of the request.

17 Q. And you were a member of the executive
18 committee, were you not, of the board?

19 A. Yes, but --

20 Q. You were also the person along with Mr.
21 Leombruno and Mr. Stemberg principally responsible
22 for the assignment of discussing Staples with
23 investment bankers were you not, that executive
24 committee?

25 A. Yes.

1 Q. And also for discussing the future
2 prospects of Staples with investment bankers as
3 well as investors?

4 A. Yes.

5 Q. I think you told me in your deposition
6 that the first you knew that there was to be a
7 financial settlement of Mr. Stemberg's divorce was
8 shortly before you approved the round D on
9 September 22, 1987, do you recall that testimony?

10 A. I recall that testimony. I recall
11 indicating that the - as to when I first learned
12 of a settlement of the divorce was very unclear as
13 to a date in my mind and, therefore, I would not
14 try and specify when it was I first heard of a
15 settlement.

16 Q. Well, in any case, the first time you
17 became aware that there was going to be a
18 settlement, a financial settlement with Mrs.
19 Stemberg, it would somehow or other involve
20 Staples, that was within a few days of September
21 22, wasn't it, as best you recall it?

22 A. As best I recall the first time that I
23 considered a, the issuance of a preferred D
24 associated with a settlement with Mrs. Stemberg
25 was in or around the time of that September board

1 meeting, yes.

2 Q. Prior to that time, sir, you had not heard
3 about any discussion, had you, about a transfer of
4 Mr. Stemberg's stock, some or all of it, to Mrs.
5 Stemberg in satisfaction of a divorce claim, had
6 you?

7 A. I frankly don't recall. I don't recall -
8 I do not recall having it discussed or recall
9 having it not discussed. I just don't recall.

10 Q. Well, do you recall testifying in your
11 deposition that it seemed to you that all of this
12 was coming together very quickly?

13 A. That the conversion --

14 THE COURT: When you say "all of
15 this" would you be more specific.

16 Q. Let me go back to the deposition itself.

17 MR. DWORK: May I have a page.

18 Q. Do you recall testifying --

19 MR. DWORK: Which book and which
20 page?

21 MR. WALSH: Approximately 176.

22 MS. START: Which deposition?

23 MR. DWORK: I'm sorry.

24 MR. WALSH: 176 I believe.

25 MR. DWORK: Of which one?

1 MR. WALSH: One. It appears to be
2 the wrong page. We'll have to come back to that.

3 Q. In any case, sir, do you recall feeling
4 around September 22 that the creation of the class
5 of stock that became known as D was happening very
6 quickly?

7 A. Yes, the proposal with regards to the
8 creation of a Class D came to my attention
9 relatively a short period of time before the board
10 meeting as I recall.

11 Q. And it came to your attention, did it not,
12 in the form of a memorandum that you received from
13 Andy Nichols?

14 A. Yes, I do recall receiving a memorandum to
15 that effect. I do not recall discussing it prior
16 to the receipt of the memorandum but I may well
17 have discussed it with Mr. Stemberg or other
18 investors prior. It just was not, it's not
19 highlighted in my memory.

20 Q. But you don't remember doing that, do you,
21 sir?

22 A. No, I don't.

23 Q. And in the memo that you received from Mr.
24 Nichols he outlined, did he not, a series of
25 things that were hoops, if you will, legal hoops

1 that would have to be jumped through in order to
2 create the Class D? Isn't that the substance of
3 his memo as you recall it?

4 A. I don't recall the memo well enough to
5 recall what he said in his memo other than there
6 was a proposal to create a class that would help
7 solve the need of division of property between Mr.
8 and Mrs. Stemberg.

9 Q. Well, do you recall being advised that in
10 order to create this class of stock you were going
11 to need approvals of various classes of
12 stockholders, do you recall that?

13 A. I have the document before me which I did
14 read and to say - I do not recall what had to be
15 done from the document but I am confident that to
16 create a preferred D I knew that that would
17 require approval of the various classes of stock
18 to do so.

19 Q. The Class A holders had the vote in --

20 A. That's correct.

21 Q. As a class?

22 A. That's correct.

23 Q. As did the B?

24 A. That's correct.

25 Q. Did the common shareholders have to vote

1 on that?

2 A. I don't recall.

3 Q. What they were voting on, sir, was the
4 waiver of a restriction, indeed several
5 restrictions imposed upon Mr. Stenberg's stock
6 pursuant to the employment and employment related
7 agreements that he had, right?

8 A. That's correct.

9 Q. And there were, a new certificate of
10 incorporation had to be prepared to file, right?

11 MR. DWORK: Your Honor, if he's
12 going to use the document then I think the
13 document ought to be put in evidence so that The
14 Court has it.

15 THE COURT: Well, is there a
16 document?

17 MR. DWORK: Yes.

18 THE COURT: Are you talking about a
19 memo from Andy Nichols?

20 MR. WALSH: There is a portion of a
21 document, Your Honor, No. 1. No. 2, I'm simply
22 asking the witness if this is his recollection. I
23 don't have any problem if he's referred to it
24 himself.

25 MR. DWORK: He's asked what's

1 contained in the memo.

2 MR. WALSH: I'm not asking what's
3 in the memo. I'm asking him what had to be done.

4 MR. DWORK: No, you asked him if
5 the memo said that.

6 A. My recollection as to what had to be
7 done --

8 THE COURT: You can have the
9 question.

10 MR. WALSH: Thank you.

11 A. My recollection as to what had to be done
12 was that what we basically were told by Mr.
13 Nichols what had to be done and we did the things
14 he told us we had to do. And I didn't pay very
15 much attention as to which classes had to vote in
16 which order, et cetera. He had a list of things
17 we had to do and we fell into that process. The
18 deliberation was one that the board made as to
19 whether or not this was something that we thought
20 should be done. And we had to make our own
21 deliberation as individual investors as well.

22 Q. Ultimately you did, in fact, approve to
23 create this new class, right?

24 A. That's right.

25 Q. One of the things that had to be done in

1 order to create the D was to get the vote to waive
2 the restrictions, wasn't it? In fact, the board
3 had to vote for that too, didn't they?

4 A. I believe that's correct.

5 Q. And one potential option that you had was
6 to simply do that and allow the transfer of the
7 stock by Mrs. Stemberg to third parties without
8 creation of a new class of securities, wasn't it?

9 A. Could you repeat the question? I'm not
10 quite sure --

11 Q. Sure. One of the options that you had in
12 front of you as a member of the board of directors
13 on September 22 instead of creating a brand new
14 class of securities was to simply waive the
15 restrictions on Mr. Stemberg's common to permit
16 Mrs. Stemberg to sell the same 4 or 500,000 shares
17 to third persons, right?

18 A. That was not an option which was raised to
19 the board at the board meeting so far as I can
20 recollect but --

21 Q. Did anyone ask why not?

22 A. I don't recall. But it certainly was one,
23 it was an option. There are a wide range of
24 options as to how to allow a settlement of
25 property between Mrs. Stemberg and Mr. Stemberg.

1 I do recall actually that there was a discussion
2 of why, it was a very extensive discussion as to
3 why we needed to create a D, Class D and give
4 preferred than just to give her common shares.

5 Q. Do you recall as part of that discussion,
6 sir - first of all, did Mr. Stemberg join in that
7 discussion?

8 A. He left the board room for the
9 deliberation which we had. I don't recall exactly
10 when he left the room.

11 Q. Did he indicate before he left the
12 room --

13 MR. DWORK: Could he finish the
14 answer, Your Honor.

15 MR. WALSH: Your Honor, I think
16 he's going way beyond what's responsive anyway.

17 THE COURT: He's entitled to finish
18 his answer. If he goes beyond you can move to
19 strike but you can't --

20 A. The thought has left me so go ahead.

21 THE COURT: Left you in the
22 meantime. In that case you finished. Go ahead.

23 Q. Thank you, Your Honor. Before you
24 caucussed if you will without Mr. Stemberg at the
25 board meeting did Mr. Stemberg say anything to the

1 members of the board of directors with respect to
2 the need not to simply have a transfer of common
3 but to create a new class of security instead?

4 A. As I recollect either at the board meeting
5 or in private discussions before the board meeting
6 he indicated the reasons why he believed we needed
7 to create a preferred D rather than to transfer
8 common.

9 Q. Did he tell you that the reason that he
10 needed to do that was because if you simply
11 transferred common there would be a record
12 transaction at a record price relative to fair
13 market value which might be different from what
14 the board said price was?

15 A. I do not recall that as the reason which
16 he described.

17 Q. Did he say anything to you about his view
18 that the new class of securities should be sold to
19 offshore investors?

20 A. No, I don't recall that, I'm sorry.

21 Q. Do you remember any discussion with you
22 and Mr. Stemberg in which he reported to you that
23 by selling to the Kuwaitis they would be offshore
24 investors and, therefore, less likely to run into
25 problems over the board's set value?

1 A. I don't recall that, no.

2 Q. Did you know at the time you approved the
3 Class D that Mr. Stenberg had identified Kuwaiti
4 investors as potential acquirers of this class of
5 security?

6 A. No, I did not know that.

7 Q. Now, yesterday before we, just before you
8 had your car problems, sir, we were talking about
9 a Mr. Meadow from William Blair, do you recall
10 that?

11 A. Yes.

12 Q. With regard to Mr. Meadow I think you
13 indicated that at the Sears discussions that
14 Staples was engaged in, were ongoing at the time
15 you spoke to Mr. Meadow, that's something you
16 would disclose to him, that's what you said
17 yesterday, right?

18 A. That's correct.

19 Q. Now, since last night, sir, or since we
20 finished here yesterday have you discussed your
21 conversation with Meadow with anyone else?

22 A. Yes, I asked Tom if he could refresh my
23 memory as to when I spoke with Mr. Meadow.

24 Q. And did Mr. Stenberg refresh your memory,
25 sir?

1 A. Yes.

2 Q. What did he tell you was when you spoke
3 with Mr. Meadow?

4 A. He reminded me that it was Mr. Meadow that
5 called me, not me that called Mr. Meadow and that
6 Mr. Meadow said that he had an inquiry from a
7 representative of Sears who expressed interest in
8 Staples and were we interested. So it was him who
9 had called me first and as Mr. Stemberg indicated
10 that I did recall, indeed, it was Scott Meadow who
11 called me and introduced me initially to Bob Lee
12 of Dean Witter and then Alan Minoff of Sears.

13 Q. And the phone call from Mr. Meadow, sir,
14 occurred on or about September 1, did it not?

15 A. I really can't be that specific as to the
16 timetable but it was approximate to the time when
17 discussions with Sears began which were in the
18 fall, that time period.

19 Q. Well, in relation to the round C approved
20 September 22 at the board meeting, it was prior to
21 that, wasn't it?

22 A. I believe so, yes.

23 Q. And as a matter of fact, by September
24 10th, 1987 Sears had issued to Staples a mutual
25 nondisclosure agreement or proposed at least at

1 that point mutual nondisclosure agreement, had
2 they not?

3 A. I don't again recall the specific date but
4 I do recall a mutual nondisclosure statement
5 entered into between the companies and Sears
6 associated with these discussions.

7 Q. Do you recall that the company received
8 that on or about September 10, 1987?

9 A. I don't.

10 Q. By the way, sir, do you have your diary
11 for September 1987?

12 A. I believe so. I don't have it with me.

13 Q. You didn't have it at your deposition
14 though, did you?

15 A. I don't believe so. I don't recall.

16 Q. Do you recall making a phone call at that
17 time to your secretary to determine whether or not
18 you had either telephone records for the period or
19 a diary for the period?

20 A. I do recall making a call to my secretary
21 to ask her to see if she could find my diary and
22 she couldn't.

23 Q. And she what?

24 A. She could not.

25 Q. In any case, sir, back with Mr. Meadow for

1 a minute, Meadow reported to you, did he not, that
2 Sears wanted to talk to Staples?

3 A. That's correct.

4 Q. And they wanted to know whether or not
5 Staples was willing to talk to Sears, right?

6 A. Correct.

7 Q. And you told Mr. Meadow, did you not, that
8 the company was not for sale but you'd be willing
9 to listen?

10 A. That's correct.

11 Q. And did you also tell him that they should
12 be in touch with Mr. Stemberg, that is Sears
13 should be in touch with Mr. Stemberg, either Sears
14 or Mr. Meadow?

15 A. As I recall the process actually Mr.
16 Meadow suggested that I talk with Mr. Lee at Dean
17 Witter which I then did. But I certainly would
18 have, and my recollection as to what I told Mr.
19 Meadow on that particular conversation is fuzzy at
20 best but I certainly would have indicated it was
21 going to ultimately be a discussion between Mr.
22 Stemberg and Sears that would have to occur.

23 Q. And, in fact, sir, did you report to -
24 well, let me ask you this first: How long after
25 your first call from Mr. Meadow did you speak with

1 Mr. Lee for the first time?

2 A. Within I'd say a week to ten days of the
3 call from Mr. Meadow. I don't recall the specific
4 period.

5 Q. It's fair to say, isn't it, that - just
6 for the record Mr. Lee is Bob Lee, is that right?

7 A. That's correct.

8 Q. And what was Bob Lee's position in
9 September of 1987 as best you understood it at
10 least?

11 A. I believe he was a senior officer in the
12 merger and acquisition department of Sears. He
13 may have been director of that department, I don't
14 recall, located as I recall in Chicago, not in New
15 York.

16 Q. And in the course of your discussion then
17 with Mr. Lee did you report to Mr. Lee that there
18 was sort of a minimum price that if Sears wasn't
19 willing to consider there was really no point to
20 further discussions?

21 A. I don't believe I did in that first
22 telephone conversation, no. But in subsequent
23 conversations I did.

24 Q. What was that figure that you reported to
25 Mr. Lee as being sort of the minimum, if he wasn't

1 going to meet that there was no point in even
2 talking further?

3 A. As I recall it was in the 100 million to
4 \$120 million range.

5 Q. Prior to making that report to Mr. Lee you
6 had discussed that subject with Mr. Stemberg,
7 isn't that so?

8 A. That's correct.

9 Q. There came a time, did there not, shortly
10 after that in which there was a meeting between
11 Mr. Stemberg on the one hand and Mr. Minoff and
12 the other --

13 A. That's correct.

14 Q. And Mr. Minoff's position with --

15 THE COURT: Will you spell his
16 name.

17 Q. Minoff, M I N O F F, Your Honor. And the
18 meeting with Mr. - Minoff's position with Sears
19 was what, sir, as you understood it?

20 A. Junior analyst in the financial
21 department.

22 Q. That was your understanding of his title?

23 A. I'm not sure what his title was. That's
24 what he was.

25 Q. What was his title, sir?

1 A. Analyst, financial analyst.

2 Q. It wasn't a vice president?

3 A. I don't know.

4 THE COURT: For Sears?

5 A. Whether it was Sears or a division of
6 Sears I'm not sure.

7 Q. When you say "a division of Sears," it
8 might have been Dean Witter?

9 A. I don't believe it was Dean Witter but I
10 don't know whether he was employed by Dean
11 Witter. I thought he was employed by the finance
12 department of Sears.

13 Q. Was it your understanding, sir, at that
14 point in time in September 1987 that Dean Witter
15 was a part of Sears?

16 A. Yes.

17 Q. Do you know exactly what their
18 relationship was, was it a subsidiary or a
19 division if you know?

20 A. I believe it was a subsidiary but I don't
21 know.

22 Q. Now, in any case, in the meeting did Mr.
23 Stenberg say to Mr. Minoff that there was, there
24 was no risk that this company in two to three
25 years would be worth \$200 million?

1 THE COURT: Excuse me, Mr. Walsh.
2 When you say a meeting, I don't recall any
3 evidence so far there was a meeting.

4 MR. WALSH: I thought we had
5 established that. Let me back up then.

6 THE COURT: He said that he
7 furnished Mr. Lee with a figure which he had
8 previously discussed with Mr. Stemberg. And then
9 you went from Mr. Meadow of Sears to Mr. Lee of
10 the merger and acquisition department of Sears and
11 now we're dealing with Mr. Minoff. You lost me as
12 to how Mr. Minoff even came into the picture.

13 Q. There was a meeting, was there not, after
14 your discussion with Lee between Stemberg and
15 Minoff?

16 A. As I recall there was a meeting between
17 Stemberg, Minoff, Mr. Lee and myself.

18 Q. And with respect to that meeting, sir --

19 THE COURT: Can we establish when
20 that occurred? Do you have any memory as to when
21 that occurred?

22 A. I do not have a memory as to when that
23 occurred unfortunately. And perhaps my diary
24 could help solve that if that became critical.

25 Q. You can't find your diary though, can you?

1 A. I couldn't find it. My secretary couldn't
2 find it. Could I find it, perhaps. And would it
3 have that entered in it on the calendar? Mr.
4 Stemberg I presume would have this on his
5 calendar.

6 THE COURT: In terms of a rough
7 approximation, would the fall of '87 --

8 A. Yes, I believe it would be September of
9 '87, maybe into October but I believe it was in
10 the September of '87 time period.

11 Q. Did Mr. Stemberg say in the course of the
12 meeting that there was no risk that in two to
13 three years Staples would be worth \$200 million?

14 A. No.

15 Q. He didn't say that?

16 A. No.

17 Q. Did he say that the only discount that was
18 appropriate was the cost of capital?

19 A. I don't recall him saying that but he may
20 have. I'm not quite sure what that means.

21 Q. I take it you took no notes during the
22 course of that meeting?

23 A. That's correct.

24 Q. Did Mr. Stemberg?

25 A. I don't know.

1 Q. Did you observe him taking any notes?

2 A. I don't recollect.

3 Q. In any case, sir, before you and Tom went
4 to the meeting --

5 THE COURT: Before you get into
6 that do you recall where that meeting occurred?

7 A. Yes, I believe --

8 THE COURT: Was it in Chicago?

9 A. I believe it occurred in the offices of
10 Bain & Company in Boston.

11 THE COURT: This would have been in
12 your office?

13 A. A conference room of Bain & Company, yes.

14 THE COURT: Thank you. Go ahead.

15 Q. Now, prior to the meeting with Mr. Minoff
16 I think you indicated you had spoken with Mr.
17 Stenberg concerning the price put out to C for
18 consideration before there'd even be a meeting
19 with Mr. Minoff?

20 A. That's correct.

21 Q. That price you indicated I think was
22 somewhere in the range of 100 to \$120 million?

23 A. That's correct.

24 Q. With respect to that price, sir, before
25 the round C memorandum was actually approved had

1 you done some calculations to determine what you
2 expected the IPO price of this company to be,
3 future value of the company Staples?

4 THE COURT: At what point in time?

5 Q. Prior to the approval of the Class C
6 memorandum on September 22.

7 A. Yes.

8 MR. DWORK: I assume the question
9 means reasonably close to that.

10 Q. Reasonably close, yes, within six weeks,
11 eight weeks, something like that.

12 A. Yes, prior to our investing in round C I
13 made an assessment of the future potential value
14 of Staples if it were to accomplish its
15 objectives.

16 Q. And its objectives were those as set forth
17 in the business plan as amended, is that fair to
18 say?

19 A. Yes, although I adjusted those plans in
20 making my own calculation as to what would occur.

21 Q. The business plan as amended was set
22 forth, the business plan for the company at least
23 as amended was set forth in the Class C
24 memorandum, was it not?

25 A. I believe it was.

1 Q. But you made some adjustments to that for
2 purposes of your own thinking and your own
3 calculations?

4 A. That's correct.

5 Q. That's typically what you do, isn't it,
6 prior to making an investment in a company?

7 A. Yes.

8 Q. Now, you have not testified before in
9 Massachusetts as an expert witness, have you, on
10 the issue of valuation at least?

11 A. No, I have not.

12 Q. And you've not testified anywhere else as
13 an expert on valuation, have you, sir?

14 A. That's correct.

15 Q. And no one else in your company does that
16 on a regular basis, do they?

17 A. On a regular basis, no.

18 Q. With regard to the method that you've put
19 up here on my chart, Mr. Dwork seems to have
20 amended on me, could you tell us please, sir,
21 whether or not to the best of your knowledge any
22 court has ever accepted that methodology?

23 A. The methodology which I applied I would
24 characterize as different than you described it
25 yesterday. You described my methodology as one of

1 a probablistic analysis of various outcomes.

2 My methodology which I described to
3 The Court yesterday was saying what an experienced
4 investor would pay for one share of stock that had
5 a certain right vs. a share of stock that did not
6 have that right. I did not base my analysis as
7 described yesterday on probablistic outcomes.

8 Q. Did it play any role in your
9 determination, sir?

10 A. Yes.

11 Q. As a matter of fact, when you did your
12 chart for the deposition you outlined in some
13 detail the various probabilities of a whole number
14 of events occurring, didn't you?

15 A. That's correct.

16 Q. Do you have what was Exhibit 5 in your
17 deposition with you today?

18 A. Yes, I do.

19 MR. WALSH: I wonder if we could
20 have it marked for identification, Your Honor, so
21 I can examine him on it or a copy of it.

22 THE COURT: You can examine him
23 without it being marked. You don't intend to
24 introduce it into evidence anyway.

25 MR. WALSH: No, I simply would like

1 to have it marked, Your Honor, so when Mr. Beach
2 testifies he will have something to refer to
3 directly as what came from this witness.

4 THE COURT: It can be marked for
5 identification. I think we're up to Exhibit
6 No. --

7 MS. STARR: L I think, Your Honor.

8 THE COURT: Sounds right. Exhibit
9 L for identification and where is the document?
10 Let me mark it. Can we exclude the letter and the
11 map from, Mrs. Starr, is that all right?

12 MR. WALSH: Yes.

13 MS. STARR: Unless you want to keep
14 the map, Your Honor.

15 THE COURT: The directions might
16 help me find my way home.

17 MR. WALSH: There should be four
18 pages or five pages.

19 THE COURT: Exhibit L for
20 identification will be some handwritten notes
21 prepared by Mr. Romney.

22

23 (Exhibit L for identification Handwritten notes
24 marked)

25

1 THE COURT: Mr. Walsh, you can take
2 that back.

3 MR. WALSH: Thank you, Your Honor.

4 THE COURT: I assume there's no
5 extra copy that's floating around that I can
6 follow?

7 A. Here's an extra copy here if you like.

8 MR. DWORK: I gave it to the
9 witness if you like.

10 THE COURT: Why don't I keep the
11 one that's marked.

12 Q. Mr. Romney, before we delve into that I
13 found the reference in the deposition that we were
14 discussing a little while ago. This was in the
15 June 20th deposition, I'm not sure which day that
16 is, on page 180.

17 MR. DWORK: May I have just a
18 moment, Mr. Walsh. Starts off "Now, by
19 September"?

20 Q. That's the page, yes. And you were asked
21 the following question, sir:

22 "Question: Now, by September of
23 1987 you were certainly aware Mr. and Mrs.
24 Stemberg were separated?

25 "Answer: Yes.

1 "Question: When was the first time
2 you learned that the Stembergs were actually
3 planning a divorce?

4 "Answer: I don't recall precisely
5 but I recall that the first time that I did not
6 learn a good deal of time before the board meeting
7 at which we decided to characterize the 400,000
8 shares of Class D preferred. So it was not a long
9 time before that meeting. It could have been
10 several weeks, a couple of months but it could
11 have been only actually a couple of days. I do
12 remember feeling all this was happening very
13 quickly."

14 Do you recall that testimony?

15 A. Yes.

16 Q. Was that accurate testimony?

17 A. Yes.

18 Q. Now, sir, if we can go back to where we
19 were with your chart. Now, you prepared this
20 handwritten chart for purposes of both answering a
21 set of interrogatories and providing oral
22 testimony at a deposition that had been permitted
23 by The Court, didn't you?

24 A. That's correct.

25 Q. And how long before you prepared the, how

1 long before the deposition I should say was it
2 that you prepared these four handwritten pages?

3 A. I believe several weeks because the
4 depositions were delayed several times. So I
5 prepared them well before the depositions.

6 Q. And approximately how long did it take you
7 to write down your, to come to your conclusions
8 and write down your thoughts on that document?

9 A. A couple of days.

10 MR. WALSH: Is that Exhibit K, Your
11 Honor, was it?

12 THE COURT: L for identification.

13 Q. Thank you. Now, sir, basically if I
14 understand what you've done here is you listed the
15 common, the preferred C and the preferred D in
16 three columns and then ran a running comparison of
17 the three based upon what rights they had and what
18 rights they might not have?

19 A. That's correct.

20 Q. AND so what you were doing, sir, in
21 essence I think is it fair to say is you were
22 pricing the D class off of the C price?

23 A. That's correct.

24 Q. And similarly you were pricing the common
25 off of the C price, is that right?

1 A. That's correct.

2 Q. And then what you would do is take a
3 series of percentages of deduction for differences
4 between the respective rights that the different
5 classes might have?

6 A. That's correct.

7 Q. And did you list, let's forget the bottom
8 part of this for just a moment dealing with the
9 transfers and the forfeiture, that was unique to
10 Mr. Stenberg, right?

11 A. Right.

12 Q. Let's just deal with the part above that
13 for the moment. With respect to the common, the
14 preferred C and the preferred D, did you list all
15 the differences between the stocks, different
16 characteristics between the stocks?

17 A. No.

18 Q. What one did you omit, one or more?

19 A. I don't recall the ones I omitted. I
20 listed all those that I considered were material
21 to my valuation.

22 Q. You did, okay. Now, one of the
23 differences between the preferred C and the
24 preferred D was that C had voting rights, isn't
25 that right?

1 A. C had voting rights. I don't recall
2 whether - I know C had voting rights, yes. I
3 don't recall whether D had voting RIGHTS or not.
4 I don't believe it did but I did not include that
5 in my valuation. I don't recall whether D had
6 voting rights.

7 Q. You don't have any recollection of whether
8 D had voting rights?

9 A. No, I don't.

10 Q. Before you prepared your report did you
11 review the restated certificate of condition to
12 determine the various rights of the classes of
13 stock?

14 A. I received, I reviewed a summary of the
15 various rights of the different securities which
16 had been prepared by counsel.

17 Q. And that's the document titled "Terms and
18 Conditions," is it, of classes of stock?

19 A. It may have been, I don't know.

20 Q. It's about a two or three-page document.
21 Do you have it with you?

22 A. I don't have that with me, no.

23 Q. In any case, sir, would you agree that to
24 have a voting right, a right to vote is generally
25 a valuable right in a class of security?

1 A. Very generally.

2 Q. In fact, sir, you wouldn't consider buying
3 into Staples, would you, if you couldn't get a
4 voting right?

5 A. Certainly I would.

6 Q. Certainly you would?

7 A. I would.

8 Q. You would?

9 A. Yes.

10 Q. You'd buy Staples stock whether it's
11 voting or it's not voting?

12 A. Yes.

13 Q. You don't think that having voting rights
14 in Staples is of any value?

15 A. I didn't say that.

16 MR. DWORK: Your Honor, I think
17 there has to be a distinction between ordinary
18 voting rights and class voting rights.

19 Q. We're talking about ordinary voting
20 rights, correct, sir?

21 A. That's right.

22 Q. You did include class voting rights?

23 A. That's right.

24 Q. Which you thought was a class of some
25 value?

1 A. That's right.

2 Q. But you thought the right to vote
3 generally in the affairs of the corporation was of
4 no value?

5 A. I didn't say that.

6 Q. You didn't include that as a right under C
7 that increased its value, did you?

8 A. I did not include it as a right which
9 significantly increased its value as a 5 cent
10 value. As you'll note under class votes general
11 voting right was even less.

12 Q. So then if I understand you then the
13 voting rights, how much is the voting rights worth
14 as a difference between the preferred C and a
15 class of security that didn't have voting rights?

16 A. The importance of voting rights is highly
17 dependent upon what proportion of the shares one
18 owns. If I'm only going to own 1 percent of the
19 share of a security anyway then my voting rights
20 are virtually worthless. If I'm going to own 51
21 percent of a security voting rights become very,
22 very valuable and very important.

23 Q. That's true with respect to class voting
24 rights too, isn't it?

25 A. Exactly.

1 Q. You listed the class voting rights, didn't
2 you?

3 A. That's correct.

4 Q. But you didn't list the voting rights on
5 all other matters in your chart, did you?

6 A. That's correct.

7 Q. If you take the preferred D and you make
8 the deductions that you've indicated are
9 appropriate off of the Class C that results in a
10 price for the D of about \$1.75 a share, right?

11 A. That's correct.

12 Q. At least if you average your upside and
13 downside?

14 A. That's correct.

15 Q. Now, one of the rights for which you take
16 a deduction, in fact, the first one is the
17 liquidation right, liquidation preference right?

18 A. That's correct.

19 Q. And in that instance with respect to the D
20 you took off 50 cents because it came in line
21 after A, B and C, right?

22 A. And before the common, yes.

23 Q. And before the common. Then with respect
24 to the common you took off between 75 cents and a
25 dollar because it came behind the same three

1 classes of securities and the D, right?

2 A. That's correct.

3 Q. But in truth, sir, with regard to the
4 Class D, the preference that the Class D had was
5 50 cents a share, right?

6 A. That's right.

7 Q. And there were 400,000 shares of that
8 class?

9 A. That's correct.

10 Q. In its entirety, right?

11 A. That's right.

12 Q. So the total dollar value of that
13 preference would not exceed \$200,000, would it?

14 A. That's correct.

15 Q. Now, with regard to the Classes A, B and
16 C, they had liquidation preferences combined of
17 approximately some 30 or \$35 million, isn't that
18 right?

19 A. That's right.

20 Q. Then on top of that was this \$200,000
21 right that the D had, right?

22 A. That's correct.

23 Q. And then if we go over to the common,
24 common fell in line immediately behind that?

25 A. That's correct.

1 Q. So if we assume that A, B and C totaled up
2 to let's for round figures assume it was \$35
3 million, okay, can we assume that for a moment
4 that that's approximately right?

5 A. That's fine.

6 Q. And if we add to that \$200,000 to protect
7 the preferred D, correct?

8 A. Yes.

9 Q. We now have \$35.2 million in total
10 preference items, right?

11 A. That's correct.

12 Q. And then the common comes in right behind
13 that?

14 A. That's correct.

15 Q. So in the situation in which the preferred
16 D would achieve its full 50 cents right upon
17 liquidation that would come up in the situation
18 where the company was liquidated at a price
19 between 35 million and let's say 35.2 million,
20 correct?

21 A. Approximately, yes.

22 Q. So then if it sold for more than that the
23 liquidation preference for the D would have
24 already been paid off, correct?

25 A. I believe that's correct.

1 Q. And so once we're beyond on the
2 approximate number of \$35.2 million then this
3 preference right is of no further consideration,
4 is it?

5 A. Once we're beyond, I'm sorry.

6 Q. A price of about \$35.2 million.

7 A. That's correct.

8 Q. Now, let's assume, sir, that - and you
9 were not prepared to sell or recommend the sale of
10 this company at \$38 million, were you, in
11 September of 1987?

12 A. That's wrong. I can't testify as to
13 whether I would sell the company for \$38 million.
14 I can testify that I wouldn't, that I would not go
15 to someone who expressed interest in the company
16 and tell them my bottom line in my first
17 conversation with them.

18 Q. Would you recommend to your board of
19 directors at Staples in September of 1987 that
20 they sell the company for \$38 million?

21 A. Perhaps.

22 Q. Perhaps. With all you knew at that time
23 in September 1987?

24 A. I don't think I would have but it's a
25 possibility, yes.

1 Q. Now, you don't think you would have.
2 Which is it, sir?

3 MR. DWORK: I pray Your Honor's
4 judgment.

5 A. I said perhaps. That's what perhaps means
6 I believe.

7 THE COURT: He can stand with what
8 he said. He said perhaps he might have.

9 A. I think in the specific circumstances
10 September of 1987 I would not have wanted to sell
11 for \$38 million.

12 Q. All right. And that's what you said in
13 the deposition too, isn't it, that you would not
14 want to sell at \$38 million, correct?

15 A. I don't recall the deposition but that's
16 consistent with what I've just said.

17 Q. Now, sir, let's assume for a minute -
18 well, the difference between the preferred D and
19 the common with respect to the liquidation
20 preference, sir, is between 25 and 50 cents,
21 right, just on that right?

22 A. Yes, that's right.

23 Q. And as we then move down your chart, sir,
24 it's fair to say, is it not, if we're comparing
25 the D to the common for a moment that the dividend

1 right and the redemption right and the
2 antidilution right and the class vote and the
3 registration rights and the preemptive rights if I
4 read that correctly, in each case those rights
5 with respect to the D and the common are the same
6 in your view?

7 A. That's correct.

8 Q. And so if we ignore those for a minute in
9 getting to the differences between general common,
10 if we can call it that, and the D, the only
11 difference between the two is this liquidation
12 preference, isn't it?

13 A. That's the only substantial difference
14 that I noted, yes.

15 Q. Now, if we were to deduct from the D as I
16 think you did these various preference items as
17 you calculated them and got to our \$1.75 I take
18 it, sir, that it would be your opinion that the
19 value of the preferred D was \$1.75, right?

20 A. That's correct.

21 Q. You are aware, are you not, that there was
22 a market transaction in the D, in fact, a couple
23 of them which averaged about \$2.25 a share?

24 A. That's correct.

25 Q. So that if we had followed your

1 methodology with regard to the preferred D we
2 would have come to a price about 30 percent less
3 than what the market cleared it at, right?

4 A. As I understand the transactions occurred
5 in February of 1988.

6 Q. Approximately.

7 A. And I was looking at the value as of
8 September of 1987.

9 Q. Well, in fact, sir, when you testified in
10 your deposition you were looking at the period
11 from September to February, right, September '87
12 to February of '88.

13 A. Yes, and the --

14 Q. I'm sorry.

15 A. -- the specific time of the transaction at
16 2.90 a share was in December of 1987. And the
17 specific time of the transaction which you refer
18 as I recall is in February of 1988.

19 Q. When you prepared your chart, sir, you
20 were valuing each of those classes of securities
21 for the whole period, right, September '87 to
22 February of, the end of February of '88?

23 A. No.

24 Q. You were not?

25 A. No, the value of the securities based on a

1 market transaction would have to be specifically
2 identified as the date of the market transaction.
3 And you would adjust one side or the other based
4 upon changes in condition of the company one side
5 or the other. Although - I'll stop there I guess.

6 THE COURT: Do I understand it then
7 that your valuation that you furnished yesterday
8 is focused in on September of '87?

9 A. That's correct.

10 THE COURT: All right.

11 Q. In fact, in your deposition didn't you
12 tell me that you priced everything as of the date
13 of closing of the C in December of '87?

14 A. That's just what I said.

15 Q. And you said that in order to adjust it
16 more finely and, in fact, now that you've actually
17 testified as to the September value the September
18 value you came up with in your testimony is
19 exactly the same as what you told me in your
20 deposition was the December value, right?

21 A. That's correct.

22 Q. So there was no change between those two
23 dates, was there, in terms of your --

24 A. For purposes of this valuation and in my
25 opinion there was no change between September and

1 December.

2 Q. If we look, sir, to the February, January
3 or February time period when the market
4 transaction in the D occurred, that was within
5 approximately two months or less of your December
6 date upon which you based your record, right?

7 A. That's correct.

8 Q. And you told me, sir, in your deposition
9 that if the range of values for the whole period
10 of time needed to be narrowed down to a particular
11 date all you'd have to do is the mathematical
12 interpolation figuring out where in that range and
13 where in that point in time, where in the range a
14 particular point in time fell mathematically,
15 right?

16 A. That's correct.

17 Q. So that if your particular transaction in
18 the C fell in the mid point of a particular range
19 all you'd have to do is adjust it to account for
20 the higher price or the lower price and the date
21 of that, is that fair to say?

22 A. Yes.

23 Q. So if you had a market transaction two
24 months after February of 1987 all you'd have to do
25 is adjust mathematically for those two months,

1 right?

2 THE COURT: You mean February of
3 '88?

4 Q. February of '88. Thank you, Your Honor.

5 A. I'm not sure exactly. February of '88 and
6 the day of the transaction and preferred D there
7 was a price at 2.25 a share I would never argue
8 that the value was different than 2.25 a share as
9 of that date.

10 Q. That's because there was a market clearing
11 transaction as of that date, right?

12 A. That's correct.

13 Q. And that would be something that you would
14 consider, would you not, as really the determining
15 factor of fair market value?

16 A. Yes, unless there were some fraud or some,
17 you know, some unusual behavior but prima facie I
18 would assume a market transaction would set the
19 price.

20 Q. That was an interesting statement. Was
21 there some grounds that you had to believe that
22 there was some fraud in connection with the D
23 transaction?

24 A. None whatsoever.

25 Q. In any case, sir, so what we end up with

1 is that the preferred C and the common, forgetting
2 Mr. Stenberg for a moment, are identical except
3 with regard to the liquidation preference, is that
4 right?

5 A. I believe that's correct, yes.

6 Q. But there is the difference of the voting
7 rights that the D had that you didn't account for,
8 right, but you think it has no value?

9 A. I think it has very limited value.

10 Q. So in any case, whatever value it has it's
11 something that would lower the price of the D as
12 compared to the common, right?

13 A. That's correct.

14 Q. It's certainly a minus, not a plus, right?

15 A. That's correct.

16 Q. Now, did you read all of the rights of all
17 of the classes of securities that were summarized
18 in that little chart that you had?

19 A. I did at the time I prepared my valuation,
20 yes.

21 Q. Were you satisfied that it fairly and
22 accurately reflected what was your memory of what
23 those terms and rights were?

24 A. My memory was very weak, indeed, as to
25 those terms and rights so it did not conflict with

1 my memory.

2 Q. So you basically accepted it, right?

3 A. That's correct.

4 Q. Let me show you a document, sir. I'm not
5 sure if this is in evidence or not, Your Honor.
6 And I'll just ask you if this is the summary that
7 you were referring to?

8 A. This appears to be the summary I was
9 referring to.

10 MR. WALSH: I wonder if I could
11 inquire, Your Honor, if we already had this marked
12 for identification titled "Terms and Rights of
13 Capital Stock"? If it isn't I would like to mark
14 it.

15 MS. STARR: K.

16 THE COURT: J was it marked?

17 MS. STARR: K.

18 MR. WALSH: If we have K here I can
19 just examine it.

20 THE COURT: Why don't you go ahead
21 and help yourself, Mr. Walsh, to the exhibit box.

22 MR. WALSH: It doesn't appear to be
23 in that batch, Your Honor. Your Honor, if it's
24 all right with Your Honor I can continue. He has
25 a copy and I have a copy.

1 Q. Sir, you have a copy of the Terms and
2 Rights of Capital Stock in front of you that you
3 relied upon?

4 THE COURT: I looked in my notes
5 now and I see Exhibit K for identification was a
6 document that was described as Terms and Rights of
7 Capital Stock of Staples, Inc. consisting of about
8 seven pages. That's been previously marked.

9 Q. Thank you. Sir --

10 THE COURT: Where the document is
11 is another story.

12 MR. WALSH: I think it's just in
13 another pile, Your Honor. The rest of them are
14 all there.

15 Q. Sir, if you can take a look at K for
16 identification. That is, indeed, the document
17 that you relied upon in determining what the
18 various rights of the classes stock were?

19 A. That's correct.

20 Q. If you'll look at page 4, sir, that sets
21 forth, does it not, the ten rights of the Class D
22 preferred stock or a summary of them?

23 MR. DWORK: I don't have it before
24 me. Did you say B?

25 Q. D, D.

1 A. Yes, I believe it does, yes.

2 Q. That conforms to your memory of what those
3 rights were, right?

4 A. Yes, it does.

5 Q. Now, sir --

6 THE COURT: I have it. Go ahead.

7 Q. Now, sir, on page 4 of that document
8 there's a, one of the rights that is set forth
9 there is titled conversion rights and it talks
10 about each share is convertible into one share of
11 common stock, you see that?

12 A. Yes.

13 Q. That's not different from the rights of
14 the other classes, is it, in the event of an IPO
15 or a transfer of the company, indeed, all the
16 preferreds are converted, isn't that so?

17 A. That's correct.

18 Q. Then it says that there's no antidilution
19 provisions. Then it says, "mandatory conversion
20 at any time at the option of the company," do you
21 see that?

22 A. Yes.

23 Q. And somebody underlined that, that
24 sentence. Did you underline it, sir?

25 A. No, I didn't.

1 Q. Now, I take it, sir, that when you value a
2 class of securities or you value anything in
3 relation to either stock or company one of the
4 things that you do is you try to make sure that
5 you have all the rights and conditions of either
6 the class of security or the company itself, is
7 that fair to say?

8 A. I'm sorry, I didn't quite get your
9 question.

10 Q. Let me strike that. Certsinly with regard
11 to valuing a class of security before you do that
12 you make sure you know what all the rights are in
13 that class, right?

14 A. Yes.

15 Q. And particularly if you're going to go out
16 and actually buy it or at least you're thinking
17 about buying it you make certain that you know
18 what the rights are, right?

19 A. That's correct.

20 Q. That's part of your due diligence, isn't
21 it. So in order to, and you take that into
22 account, do you not, in determining the value of
23 what it is that you're going to pay?

24 A. Yes.

25 Q. Now, the mandatory conversion at any time

1 at the option of the company was a right unique to
2 the D, wasn't it?

3 A. To the?

4 Q. D.

5 A. Yes, as I look at the other shares it is
6 unique to the D.

7 Q. So none of the other classes had that,
8 right?

9 A. So far as I can see from this summary
10 that's correct.

11 Q. So you as a sophisticated buyer, sir,
12 would know having done your due diligence and
13 having looked at the rights and classes of the
14 stock that if you were to buy Class D stock the
15 company at its option could turn it into common
16 whenever it wanted, isn't that so?

17 A. This summary suggests that, yes.

18 Q. And so when you make your decision to buy
19 or not buy you have to do it with that in mind,
20 right?

21 A. That's correct.

22 Q. So you know when you buy the D that in
23 effect what's going to happen is if the company
24 chooses to do it whether you like it or not you're
25 going to be sitting there holding common, not D?

1 A. That's correct.

2 Q. That, in fact, was your understanding,
3 wasn't it?

4 A. That's correct.

5 THE COURT: By the way, Mr. Walsh,
6 I noticed the liquidation right was \$1.50 a
7 share. You've been using the figure 50 cents per
8 share. Was that presplit? Is that an error?

9 MR. WALSH: I think this is wrong
10 and the witness obviously did too because he
11 listed the 50 cents price. This document, Your
12 Honor, was not prepared by us.

13 THE COURT: Unless this was a
14 presplit price.

15 A. This is pre, I believed this was presplit
16 because the other securities also have the same
17 higher, everything is three times higher than I
18 used.

19 THE COURT: So the \$1.50 represents
20 a presplit?

21 A. That's correct.

22 THE COURT: Liquidation rather.
23 That became, it was originally then a 50 cents per
24 share liquidation value?

25 A. That's correct.

1 Q. Now, if we were to look at the certificate
2 of conditions, sir, itself - have you had a chance
3 to do that?

4 A. I have seen that. I've not seen it in a
5 good deal of time.

6 THE COURT: By the way, the
7 liquidation right - that's Class A?

8 A. The 8.70.

9 THE COURT: The 8.70 would be the
10 2.90 times three?

11 A. Right.

12 THE COURT: So this is all
13 presplit, pre-reversed split figures.

14 Q. Sir, if we look at Exhibit No. 9 in this
15 case the restated certificate of condition dated
16 October 30, 1987 on page 37 of that document, it
17 starts the listing of the rights of the Class D
18 and the full legal description, right?

19 MR. DWORK: What page is that?

20 Q. 37 is where it starts. Then if you turn
21 over it continues on to page 38 and I believe
22 beyond that, is that right?

23 A. Yes.

24 Q. If you look on page 38 under section 4,
25 "Conversion," part B titled "Automatic

1 conversion," that's where it's set forth, is it
2 not, that the company at any time can convert
3 whoever owns the D into common?

4 A. That's correct.

5 Q. Now, somebody who paid 2 and a quarter
6 like our friends the Kuwaitis for the stock did so
7 with the knowledge, did they not, that they could
8 be made into common?

9 MR. DWORK: Objection, Your Honor,
10 on what knowledge they had.

11 THE COURT: I'll sustain the
12 objection. He has no way of knowing what
13 knowledge the Kuwaitis had.

14 Q. You would expect --

15 THE COURT: And he apparently
16 didn't have much knowledge of imminent invasion so
17 I'm not sure whether they have knowledge of the
18 attributes of the D stock.

19 MR. WALSH: They were sophisticated
20 before those days I'm told, Your Honor.

21 Q. Mr. Romney, as an expert, sir, when you're
22 determining fair market value you assume a
23 knowledgeable buyer and a knowledgeable seller in
24 the transaction, don't you?

25 A. That's correct.

1 Q. And a knowledgeable buyer in a transaction
2 acquiring a class of security like the D would in
3 your view be sure to know these very rights that
4 you said if you were buying the stock you would
5 know?

6 A. That's correct.

7 Q. And so you would expect as an expert,
8 would you not, sir, that a buyer of the D would be
9 aware of that provision?

10 A. That's correct.

11 Q. And so when they paid 2 and a quarter a
12 share for that class you would expect that they
13 would be aware that they could be left with common
14 if the company wished it?

15 A. They should have been aware of that if
16 they were knowledgeable and studied their terms.

17 Q. Wouldn't that indicate to you, sir, that
18 the value of the common was 2 and a quarter a
19 share?

20 A. It would be close to 2 and a quarter a
21 share if at the time of the transaction of the
22 preferred D the value of the common would be,
23 obviously - I say obviously, could not be far
24 disparate from the value of the D. The two would
25 have to be relatively close in value.

1 Q. But you had it down as \$1.40 to \$1.80 or
2 rounded off, I'm sorry, \$1.10 to \$1.50?

3 A. That's right.

4 Q. Rounded to \$1.30?

5 A. That's correct.

6 Q. So you were off by about half, right?

7 A. No. I had the difference in value between
8 the two between 25 cents and 50 cents a share
9 which was not half.

10 Q. Between 25 and 50 cents?

11 A. That's correct.

12 Q. Based upon the way you deduced the numbers
13 to arrive at the price of the D, right, but if you
14 look back at the actual market transaction in the
15 D --

16 THE COURT: Talking about the
17 transaction in February now?

18 Q. Transaction in February in the D the
19 indicated value of the D was 2 and a quarter,
20 wasn't it?

21 A. I have no difficulty with 2 and a quarter
22 being the value of the D in February. The
23 methodology I would apply would be to look at
24 knowledgeable buyers and sellers in an arm's
25 length transaction arriving at a sale price.

1 Q. You would agree, would you not, that that
2 is the most reliable indicator of value, a market
3 transaction if you can find one?

4 A. Yes, where you can find a knowledgeable
5 buyer and seller, where that occurs that is in my
6 opinion the most reliable source of valuation.

7 Q. And so then if the D was worth in February
8 2 and a quarter a share how would you value the D
9 as of December 1987 at the time the C round
10 closed?

11 A. You have to repeat the timing because I
12 thought you were going to ask a different
13 question.

14 Q. The preferred D you told us clearly had a
15 value of 2 and a quarter or so a share as of the
16 February transaction, right?

17 A. Yes.

18 Q. And as of the time the C closed in
19 December of 1987 you would adjust that price back
20 for two months in order to figure out what D was
21 worth at that time, wouldn't you?

22 A. That's correct.

23 Q. And tell us how you do that?

24 A. How I would adjust the D back to
25 December?

1 Q. Yes.

2 A. I'd look at the C in December which was a
3 transaction which occurred in December and adjust
4 off of the C.

5 Q. With regard to backing the D to September
6 you would do the same thing, wouldn't you, you'd
7 look to the date of the C and back up to
8 September?

9 A. That would be one methodology.

10 Q. That's the methodology you told me you
11 used in your deposition, isn't it?

12 A. That is the methodology I used. You asked
13 what I would use. That is the methodology I used.

14 THE COURT: Do I understand it then
15 that in February of '88 the Kuwaiti group paid 2
16 and a quarter a share for the D and you agree that
17 that's probably the best test of fair market
18 value?

19 A. Yes.

20 THE COURT: An actual transaction?

21 A. Yes. I'm not aware of any of the
22 circumstances around that purchase and sale but
23 I'm assuming knowledgeable buyer and seller.

24 THE COURT: Assuming knowledgeable
25 buyer and arm's length deal and do I understand it

1 that the value of the, that the value of the
2 common in February of '88 would be approximately
3 the same?

4 A. I would give it a small discount but
5 approximately the same as the D.

6 THE COURT: Okay. We're talking
7 February now of '88?

8 A. February of '88, that's correct.

9 Q. Now, I think you told the judge yesterday
10 that the value of the, or the price rather of the
11 Class C at 2.90 a share, you thought that price
12 was too high, right?

13 A. That's correct.

14 Q. And you thought it was too high in the
15 September 1987 time period, right?

16 A. That's correct.

17 Q. And, indeed, thereafter until it closed,
18 is that fair to say?

19 A. Yes, until December, yes, that's correct.

20 Q. So based upon your view of the correct
21 price of the C you would have priced it at
22 something less than 2.90 a share?

23 A. That's correct.

24 Q. But ultimately the market cleared the
25 price at the 2.90 a share, didn't it?

1 A. That's correct.

2 Q. So had the company followed your view they
3 would have been, they would have received less on
4 a per-share price, wouldn't they?

5 A. That's correct.

6 Q. I think you also told us that with respect
7 to the B round you thought that that price was too
8 high?

9 MR. DWORK: B Boston.

10 Q. B Boston. Correct?

11 A. Yes.

12 Q. You and Mr. Hardyman, in fact,
13 commiserated over that, didn't you?

14 A. That's correct.

15 Q. And you thought that that round was priced
16 too high, right?

17 A. Yes.

18 Q. Market cleared that transaction at 2.10
19 as, well didn't it?

20 A. That's correct.

21 Q. So again if the company had followed your
22 view they would have ended up with a lower per
23 share price than the market cleared, right?

24 A. That's correct.

25 Q. In each of those instances Mr. Stemberg

1 indicated to you, did he not, that the correct
2 price was the one at which the rounds were
3 actually offered, right?

4 A. That's correct.

5 Q. And although you told him you thought he
6 was wrong he was right, wasn't he?

7 A. That's correct.

8 Q. In each case?

9 A. Yes.

10 Q. And he struck you, did he not, based upon
11 your experience with him as somebody who's pretty
12 sophisticated in determining these prices, wasn't
13 he?

14 A. Yes.

15 Q. And somebody that was able to come up with
16 some pretty accurate pricing?

17 A. Yes.

18 Q. And when he told you that he could get
19 2.10 for the B you didn't believe him but he did
20 it?

21 A. I wouldn't say I didn't believe him that
22 he couldn't get 2.10 for the B. I thought that
23 was too high a price to go out asking for the B.

24 Q. In any case, you felt that that was too
25 high a price, Mr. Stemberg told you that you were

1 wrong, right?

2 A. It was never a conversation quite like
3 that.

4 Q. He told you he thought it was 2.10 and you
5 said it's less, right, is that fair to say?

6 A. The conclusion is generally correct, yes.

7 Q. And the same thing happened with the C?

8 A. That's correct.

9 Q. And both times he's right?

10 A. That's correct.

11 Q. And I assume that that increased your
12 level of confidence in his ability, at the time he
13 correctly predicted the round B price it inspired
14 your confidence in him as in terms of his ability
15 to determine correctly the price at which these
16 rounds should go?

17 A. Yes.

18 Q. As a matter of fact, the step up from the
19 A to the B was a very large step up in your
20 experience, wasn't it?

21 A. Yes, it was.

22 Q. And you were going from 80 cents to \$2.10
23 in the span of just about 12 months, right?

24 A. That's correct.

25 Q. So that indicated, that was nearly three

1 times a step up in a one-year period of time?

2 A. That's right.

3 Q. And that is, that in your experience is
4 highly unusual, isn't it? Well, let's put it this
5 way: It's highly unusual to first price it at
6 that much of a first up and then go out and get
7 it?

8 A. It's highly unusual to get venture capital
9 at any markup so but that's a high, that's a high
10 markup.

11 Q. But, nevertheless, Mr. Stemberg was able
12 to do it?

13 A. That's correct.

14 Q. And part of the reason that he was able to
15 do it in your view was that you felt he'd done his
16 homework, right?

17 A. I guess so.

18 Q. He had gone to see investment bankers --

19 MR. DWORK: I move the answer be

20 stricken, Your Honor.

21 THE COURT: He can't assume what
22 someone else may have done or not done in
23 determining what he was seeking for the price of
24 the stock.

25 Q. Well, you were aware, weren't you?

1 THE COURT: He can certainly
2 testify what he did or did not do but I don't know
3 how he can testify what someone else did.

4 Q. Well, in terms of your view as member of
5 the board of directors of Mr. Stenberg's
6 performance back at the time in September or so of
7 1986 before the round B closed you became aware,
8 did you not, that Mr. Stenberg was talking to
9 various investment bankers in New York?

10 A. Yes.

11 Q. And --

12 THE COURT: September of '86?

13 Q. September of '86, yes.

14 A. The time period is difficult for me but
15 before the Class B round he was talking to
16 investment bankers. He's talked to investment
17 bankers consistently throughout the history.

18 Q. From your experience he did so unusually
19 early, isn't that fair to say, for an
20 entrepreneur?

21 A. Yes.

22 Q. And you became aware in the approximate
23 period the fall 1986, did you not, that Mr.
24 Stenberg had talked to Donaldson, Lufkin &
25 Jenrette?

1 A. I don't recall him speaking with
2 Donaldson, Lufkin & Jenrette. I do recall Morgan
3 Stanley and I believe it was Kidder Peabody.

4 Q. Do you also recall him speaking with
5 Goldman Sachs at that time period?

6 A. Yes.

7 Q. And at Morgan Stanley at least one of the
8 people that he spoke to was a lady named Irene
9 Miller, correct?

10 A. That's correct.

11 Q. At Goldman Sachs at least one of the
12 people that he met with was a gentleman named
13 Steve Mandell, right?

14 A. That's correct.

15 Q. Did you go to a meeting with Irene Miller
16 and Mr. Stemberg in the fall of 1986?

17 A. I went to a meeting with Irene Miller and
18 Mr. Stemberg and a number of other people from
19 Morgan Stanley and also a separate meeting with
20 Mr. Mandell and I believe only Mr. Stemberg, Mr.
21 Mandell and I were together at the second
22 meeting. I don't recall the timeframe, however,
23 of those meetings.

24 Q. Well, would it be fair to say that those
25 two meetings, the one with Goldman Sachs and the

1 one with Morgan Stanley occurred in the time
2 period shortly before the round B, as in Boston,
3 closed?

4 A. I believe that's the case but I could be
5 off by a good deal of time. It could have been
6 substantially later than that but that conforms
7 generally with my memory.

8 Q. And did you with regard --

9 THE COURT: Which meeting are you
10 speaking of now?

11 MR. WALSH: Both of them, Your
12 Honor.

13 THE COURT: They occurred
14 approximately when?

15 A. I believe they were the same day and the
16 both meetings occurred in New York and they were
17 late '86 or some time in '87.

18 Q. Would it be fair to say that in any case
19 it was before the round B actually closed?

20 A. I don't recall. I don't recall. I
21 remember those meetings but they don't stand out
22 in my mind as particularly noteworthy meetings.

23 Q. Well, were you at a meeting with Mr.
24 Mandell and Mr. Stemberg at which they discussed
25 something called an equity financing memo?

1 A. Presumably, yes. Particular, discussion
2 of a particular memo doesn't stand out in my mind
3 but I do recall them discussing possibly raising
4 money for Staples, yes.

5 Q. And did you take notes at the board of
6 directors meetings that you attended?

7 A. Generally I take notes on the, I do take
8 notes but not on a separate book but rather on the
9 documents that you provide to me.

10 Q. Did you search your files to determine
11 whether or not you had any notes from your
12 director meetings for Staples for the period 1986
13 and 1987?

14 A. I provided at the deposition all of my
15 Staples files. I did not search the files,
16 however, as to minutes from various meetings.

17 Q. So you gave us everything you had
18 regarding Staples, right?

19 A. That's correct.

20 Q. Would it be fair to say that in those - do
21 you mean there were no notes of board of directors
22 meetings?

23 A. I never searched the documents to
24 determine that.

25 Q. In any case, to the meeting with Mr.

1 Mandell, approximately how long was that meeting?

2 THE COURT: Was there just one
3 meeting that you attended with Mr. Mandell and Mr.
4 Stemberg that you can recall?

5 A. I can recall a meeting in New York which
6 was about a one-hour meeting. And I'm trying to
7 recall whether any representative of Goldman Sachs
8 ever met with the board after that. I don't
9 believe so but I don't recall.

10 Q. Let me show you what's been marked as
11 Exhibit 15, sir. And ask you - it's equity
12 financing presentation September 1986. Ask you if
13 you'd take a look at that. And I'd ask you if
14 you've seen it before?

15 A. Yes, I recall a presentation of this
16 nature being reviewed as I recall by the board.

17 Q. When approximately did the board make that
18 review?

19 A. This is dated September 1986 so I would
20 presume around that time period.

21 Q. And that was in connection with discussion
22 about the price of the round B, was it not?

23 A. Yes.

24 Q. And if you'll take a look at the document,
25 sir - by the way, I'll represent to you, sir, that

1 you may see a couple of blanks such as right
2 there. These were provided by Staples' counsel
3 after they redacted certain information at the
4 time.

5 A. I see.

6 Q. But apart from where it's redacted, sir,
7 is that a document that you remember being
8 discussed at a board of directors meeting?

9 A. Yes.

10 Q. In the fall 1986?

11 A. Yes.

12 Q. And who brought the document to the
13 meeting, sir?

14 A. I don't recall.

15 Q. Was it you?

16 A. I don't believe so.

17 Q. Was it Mr. Stenberg?

18 A. I believe so.

19 Q. Is it fair to say that Mr. Stenberg led
20 the discussion at the board meeting with regard to
21 the pricing of the round B?

22 A. Yes, I believe he did.

23 Q. And in the course of the meeting did he
24 point out to the directors present that he felt
25 that the pricing of the round should be based upon

1 a \$25.25 million premoney valuation?

2 A. I don't recall that, no.

3 Q. Do you recall a discussion about two
4 competing premoney valuations, one from Donaldson
5 Lufkin at about 21 million and one from Goldman
6 Sachs at about 25.25 million?

7 A. I don't recall those specific numbers
8 being used. Although I point out again the term
9 valuation there does not relate to the value of
10 the company but I --

11 Q. Whatever it relates to that's the term,
12 right?

13 A. Yes, that's a term which we use.

14 Q. Sure. And so when it was discussed that's
15 the term that was used at the board, wasn't it?

16 A. That would be the term that was used but I
17 don't recall the numbers and who recommended which
18 number.

19 Q. Do you recall there was a dispute with
20 Felda Hardyman either at the board meeting or
21 shortly after the board meeting concerning the
22 pricing of the round?

23 A. Yes.

24 Q. In fact, Mr. Hardyman was quite vocal, was
25 he not, that pricing the round based upon a \$25

1 million price was too high?

2 A. I don't recall the \$25 million price. I
3 remember the price per share but I believe we can
4 do the calculation. If you'll tell me what 2.10 a
5 share represents in premoney valuation I can tell
6 you that that area --

7 Q. Can we agree that 2.10 a share is the
8 \$25.25 million?

9 A. If you can tell me the number of shares we
10 can agree.

11 Q. I think you just told His Honor how many
12 were raised in that round.

13 A. I need to know the shares that existed
14 prior to that round to tell you the valuation of
15 the company and I don't have that in my notes.

16 Q. Well, we can figure that out from the
17 certificate of conditions, sir. But in any case,
18 Mr. Hardyman and Mr. Stenberg got into an argument
19 over whether the price of the round was too high?

20 A. That's correct.

21 Q. And in the course of the argument Mr.
22 Hardyman said that such a stepup to 2.10 a share
23 from 80 cents was foolhardy, wasn't it?

24 A. I don't recall whether he used that term
25 but he did not think it was a good idea.

1 Q. And did he indicate that the reason was he
2 felt that, in fact, what would happen is the money
3 wouldn't get raised?

4 A. There were several reasons he felt it was
5 a mistake.

6 Q. That was one of them, wasn't it?

7 A. One of them was that Tom would not be able
8 to raise the money at that high price.

9 Q. As a result of that discussion or in the
10 course of that discussion in your hearing did Mr.
11 Stenberg point out to Mr. Hardyman that the
12 Goldman Sachs memorandum, Exhibit 15, said in
13 substance that a \$25.25 million price was a
14 realistic price at which to raise funds?

15 A. I don't recall the specific meeting but I
16 do recall that Mr. Stenberg used the Goldman Sachs
17 conclusion as evidence that he was right and Mr.
18 Hardyman was wrong.

19 Q. And so when he concluded that debate, sir,
20 about the correct price did Mr. Hardyman and Mr.
21 Stenberg discuss any future value of the company
22 in the course of their debate over whether 2.10
23 was the right number?

24 A. They probably did. I don't specifically
25 recall.

1 Q. In the course of the board meeting in the
2 fall of 1986 did Mr. Stenberg point out to the
3 board the future value of the company in his view?

4 A. I would be surprised if he did not. I
5 don't recall specifically but we would assuredly
6 have looked at what we thought the company could
7 do if we achieved our plan going forward.

8 Q. Do you recall whether or not the future
9 value of the company discussed at the time of the
10 pricing of the round B was substantially the same
11 as the future value of the company that was
12 discussed at the time of the round C?

13 A. I don't recall that but there was such a
14 wide range of values that we discussed that I
15 would be surprised if the circles didn't overlap
16 one way or the other.

17 Q. And in particular with regard to these
18 values, sir, would it be fair to say that one of
19 the things Mr. Stenberg pointed out at the time
20 the round C price was being discussed was that the
21 future value of the company as projected at the
22 time of the round B and that being projected at
23 the time of the round C was still about the same?

24 A. That is not an argument that I recall nor
25 does it have a lot of sway. But if he made it I

1 would not be surprised.

2 Q. And why would you not be surprised?

3 A. It would show that he was using a
4 consistent forecast for the future and make
5 investors have more confidence in his ability to
6 project what would happen in the future.

7 MR. WALSH: Should we take the
8 break, Your Honor?

9 THE COURT: Yes, we'll take a short
10 break.

11 (Recess)

12 Q. Mr. Romney, when you sat as a member of
13 the board on September 22nd and approved the round
14 D did you, you obviously had in mind that you were
15 creating a liquidation preference in favor of D of
16 some 50 cents, right, per share?

17 A. The specific amount - yes, the 50 cents
18 per share liquidation preference, that's correct,
19 yes.

20 Q. You understood when you voted in favor of
21 that proposition and you did vote in favor of it,
22 did you not?

23 A. Yes.

24 Q. You understood by so doing what you were
25 doing is you were inserting ahead of the common

1 and behind the other preferred shareholders a
2 liquidation preference?

3 A. That's correct.

4 Q. Now, with regard to the other classes of
5 securities, sir, in the round A the money, it was
6 a primary offering, wasn't it, money was being
7 raised and put directly into the company treasury?

8 A. That's correct.

9 Q. And with regard to the B, that was a round
10 also created to raise money for the sole benefit
11 of the company and its use, right?

12 A. That's correct.

13 Q. Again with the round C money was raised
14 for the benefit of the company, right?

15 A. That's correct.

16 Q. Now, when we got to D that was really done
17 as a favor to Tom, wasn't it?

18 A. That's correct.

19 Q. And the company did not derive any money
20 out of that?

21 A. I overstated that. Can I correct my
22 answer?

23 THE COURT: You can correct it.

24 A. You said that was done as a benefit to
25 Tom.

1 THE COURT: As a favor to Tom.

2 A. As a favor to Tom. It was something which
3 was done in my opinion, it was initiated as a
4 favor. Tom needed to have a settlement with his
5 wife so that was the genesis of it. How we
6 resolved it had to take into effect what was in
7 the best interests of the company's shareholders.

8 Q. From a monetary standpoint, however, the
9 only benefit flowed to Tom and/or Mrs. Stemberg as
10 opposed to the company on that round, right?

11 A. Yes, in terms of cash coming into the
12 company yes, there were --

13 Q. And there were no other occasions, were
14 there, sir, when a separate class of securities
15 was created for the benefit of any individual, was
16 there?

17 A. Not that I know of, no.

18 Q. So Mr. Stemberg was able to get from the
19 board this separate class of securities prepared
20 in order to satisfy his divorce case, right?

21 A. That's correct.

22 Q. No one else got anything like that, did
23 they?

24 A. No.

25 Q. And in your experience, sir, as an

1 investor through Bain have you seen this kind of a
2 device done before?

3 A. No.

4 Q. And it was not, the idea for the creation
5 of a separate class of securities was not
6 something that was your idea in the first place,
7 was it?

8 A. That's correct.

9 Q. And I think you told me in your deposition
10 you didn't know who actually came up with the idea
11 but it was not you?

12 A. That's correct.

13 Q. Now, as a result of putting this
14 liquidation preference in favor of D ahead of the
15 common was there any discussion by the board as to
16 whether or not there could be a potential lawsuit
17 by the common shareholders for suddenly inserting
18 for the benefit of Mr. Stemberg this liquidation
19 preference ahead of them?

20 A. There was a discussion as to what was in
21 the best interests of the common shareholders as
22 well as the other shareholders. A specific
23 discussion of a potential lawsuit I don't recall
24 being raised.

25 Q. Was there a discussion that the net effect

1 was that in the event, by putting this liquidation
2 preference in favor of the D ahead of common that
3 the reality was it wasn't going to make any
4 difference because based upon what the company saw
5 there was no reason to believe it would liquidate
6 at a price which would bring that into play?

7 A. No, that was not stated or discussed.

8 Q. You don't recall that kind of a
9 discussion?

10 A. No.

11 Q. Was there a discussion that in the event
12 any of the common shareholders were upset with
13 this kind of a setup you could easily fix it by
14 the automatic conversion right?

15 A. No, that was not discussed.

16 Q. It wasn't. Was there --

17 A. Not that I recall.

18 Q. Was there any discussion by the board
19 about that mandatory conversion privilege that you
20 can recall?

21 A. I don't recall the discussion by the board
22 but I recall a discussion between Tom and myself.

23 Q. And so Tom was aware of that provision?

24 A. Yes.

25 Q. Now, let me ask you about - by the way,

1 since last night, sir, did you happen to take a
2 look at your tax returns for '86 or '87?

3 A. No.

4 Q. But you told me yesterday --

5 THE COURT: Talking about his
6 personal?

7 MR. WALSH: His personal tax
8 returns, yes.

9 A. No.

10 Q. But your best recollection is that you did
11 what you're supposed to do in terms of reporting
12 the receipts of the options?

13 A. Yes.

14 Q. Is it your understanding of what you're
15 supposed to do is report the fair market value of
16 the stock?

17 A. I do not know what I'm supposed to do for
18 tax purposes receipt of options. My accountant at
19 Price Waterhouse tells me what I'm supposed to do
20 and I follow that.

21 Q. But you don't have any recollection as to
22 what you actually did, do you?

23 A. No, that's correct.

24 Q. Is it fair to say, sir, that in any case
25 you did not report as income \$1.30 a share?

1 A. That's correct.

2 Q. Now, when the Class D stock was created or
3 perhaps thereafter did the company issue any 1099
4 or other form of income statement to Mr. Stemberg
5 for the receipt of that stock?

6 A. To Mr. Stemberg?

7 Q. Mr. Stemberg, yes.

8 A. Not that I know of but it may have. I
9 have no knowledge of what the company --

10 THE COURT: Which stock are you
11 referring to?

12 MR. WALSH: The D, D as in dog.

13 THE COURT: The D stock, did that
14 go to Mr. Stemberg or --

15 MR. WALSH: Well, it was created as
16 a result of a transfer. Let me rephrase the
17 question perhaps.

18 MR. DWORK: The transfer was from
19 Mr. Stemberg for Mrs. Stemberg. She was the owner
20 of the 400,000 common, not Mr. Stemberg at the
21 time of the transfer.

22 THE COURT: Would counsel agree
23 that mechanically what happened that Mr. Stemberg
24 transferred 400,000 shares of his common stock and
25 that Mrs. Stemberg then turned in 400,000 shares

1 of common stock to the corporation in receipt, and
2 received in exchange 400,000 shares of class D
3 preferred, isn't that in summary --

4 MR. WALSH: With the proviso all of
5 that was done through an escrow arrangement, yes.

6 MR. DWORK: Thereafter she received
7 a hundred thousand shares of common at some later
8 date.

9 THE COURT: In addition to the --

10 MR. DWORK: In addition to the
11 400,000.

12 MR. WALSH: There is a term in the
13 agreement to that effect, Your Honor.

14 Q. Now, Mr. Romney, on the D, do you have any
15 recollection as to whether or not any income was
16 reported to the IRS on behalf of Mr. Stemberg as a
17 result of this particular transaction, whether it
18 be the conveyance of the common or the issuance of
19 the D?

20 A. I would have no reason to know that nor do
21 I know that.

22 Q. Now, when we were together in the
23 deposition, sir, I showed you a document that
24 referred to something called project grain belt,
25 do you remember that?

1 A. Yes.

2 Q. What did you understand project grain belt
3 to be, sir?

4 A. This was the project relating to our
5 discussions with Sears and I don't know whether
6 grain belt referred to a subsequent effort on our
7 part to solicit interest on the part of other
8 potential acquirers or investors in Staples. And
9 I don't know whether grain belt only refers to
10 Sears or whether it referred to a greater effort
11 to involve other potential acquirers.

12 Q. When was the first time you heard the term
13 project grain belt?

14 A. I don't recall but it was associated with
15 the discussion with Sears and that occurred in
16 September of '87.

17 Q. If you'll look at Exhibit No. 6. You
18 looked at that at the time of your deposition and
19 concluded that that was something that was written
20 by Mr. Stemberg, is that right?

21 A. That's right.

22 Q. And you in part made that conclusion
23 because only he and perhaps Mr. Kahn would have
24 had access to that kind of information, is that
25 right?

1 A. That's right.

2 MR. DWORK: Does Your Honor have a
3 copy?

4 MR. WALSH: It's in the exhibit
5 book.

6 THE COURT: I assume it's in the
7 exhibit box.

8 MR. WALSH: It is Exhibit 6, Your
9 Honor.

10 MR. DWORK: I can give you an extra
11 copy, Your Honor.

12 THE COURT: If you have an extra
13 copy that's fine. This was marked Exhibit No. 6,
14 was it?

15 MR. WALSH: Yes, Your Honor. I
16 believe it's now in evidence.

17 Q. With regard to Exhibit 6, sir, did you, in
18 fact, receive a copy of this document?

19 A. Yes.

20 Q. At about October 1987?

21 A. Yes.

22 Q. And did you receive it from Mr. Stenberg?

23 A. I believe that's who I received it from.

24 Q. Can you help us, sir, as to approximately
25 when in October 1987 you did receive this?

1 A. I can't as to when in October. I don't
2 recall.

3 Q. How about trying to date it around the
4 crash, having in mind the crash occurred October
5 19th can you help us as to whether it was before
6 or after that?

7 A. I'm sorry, I can't.

8 Q. On the bottom left-hand side, sir, there's
9 a list of names and a bracket and the word "only,"
10 do you see that?

11 A. Yes.

12 Q. Do you recognize the handwriting?

13 A. I don't.

14 Q. On the right-hand side is another a list
15 of names, do you see that?

16 A. Yes.

17 Q. Do you recognize that handwriting?

18 A. It looks like Tom's.

19 Q. And is it fair to say that the people on
20 the right-hand side are basically officers of the
21 company lower in rank than Tom at that time?

22 A. Yes.

23 Q. And is it fair to say that the names on
24 the left-hand side are members of the board of
25 directors plus Mr. Nichols and Mr. Kiernan?

1 A. Yes.

2 Q. And Mr. Nichols was corporate counsel and
3 secretary, was he not?

4 A. I believe so.

5 Q. And Peter Kiernan was an investment banker
6 from Goldman Sachs, was he not?

7 A. I don't recall his name.

8 Q. You don't remember his name at all?

9 A. I don't recall Mr. Kiernan, no.

10 Q. In any case, Kiernan was not a member of
11 the board of directors, was he?

12 A. That's correct.

13 Q. But the others listed on that page were?

14 A. Yes.

15 Q. And Mr. Stemberg's name of course as you
16 noted in your deposition is not one of them
17 listed?

18 A. That's correct.

19 Q. Now, do you recall a discussion with Mr.
20 Stemberg at the time you, at or about the time you
21 received this memo concerning its contents?

22 A. I do, yes.

23 Q. You do?

24 A. Yes. I mean at or around the time that I
25 received this memo we discussed the discussions

1 with Sears and what should be said to Sears and
2 that general topic.

3 Q. And was this document to your knowledge
4 given to anybody other than those that are listed
5 here?

6 A. Not that I know of.

7 Q. Did you in particular talk to Mr. Stemberg
8 about paragraph 1 of the grain belt memo?

9 A. Yes.

10 Q. What's your best recollection as to when
11 you first talked to him about paragraph 1?

12 A. Whenever we, after I had received that
13 memo we had a conversation either by phone or in
14 person, I don't recall and so it would have been
15 after the time of receipt of that memo. I don't
16 recall when it was received, some time in October
17 of '87.

18 Q. It would be fair to say, would it not,
19 that it was some time relatively soon after you
20 received the memo?

21 A. Yes, some time relatively soon. You know,
22 within a few weeks of having received it. I
23 presume it was even sooner than that but I don't
24 recall.

25 Q. Mr. Stemberg was the principal person

1 involved in the discussions with Sears on behalf
2 of Staples, was he not?

3 A. That's correct.

4 Q. And with regard to the figure in the
5 second line or statement, "In our judgment \$7.50+
6 per share represents a level of value we might be
7 able to attain in a mid 1989 public offering and
8 should accept today."

9 A. Yes.

10 Q. Did you discuss that with Mr. Stemberg,
11 that particular sentence?

12 A. Not the sentence but the concept of what
13 we should accept today and what the company would
14 be worth in the future. Yes, we discussed that.

15 Q. And did Mr. Stemberg tell you that the
16 company in the future, specifically in mid 1989
17 would be worth about \$130 million?

18 MR. DWORK: What was that figure?

19 Q. \$130 million.

20 A. Mr. Stemberg discussed what the company
21 would be worth if it hit its plan. Which if it
22 hit its plan it would be worth in his opinion that
23 \$7.50 a share which as I recall is roughly \$130
24 million, yes.

25 Q. And we arrive at that because at the time

1 this memo was issued the Class C had not been
2 issued, right, authorized but not closed?

3 A. That's correct.

4 Q. And so at that point in time there was
5 approximately 17 million shares on a fully diluted
6 basis outstanding?

7 A. My recollection is not that accurate as to
8 the number of shares that were outstanding. But I
9 believe you showed me a document in our deposition
10 which actually multiplied shares and prices and
11 arrived at 130 million.

12 Q. And the document, you recall the document
13 that you saw at the time of the deposition?

14 A. I would recollect it upon seeing it. I
15 don't recall it having a title but it had the 7.50
16 a share at the bottom of a couple of tables.

17 Q. If I can show you, sir, Exhibit 13. This
18 starts off as a letter dated September 10, 1986 to
19 Irene Miller but then there are attached
20 documents. Would you take a look at that?

21 A. Yes.

22 Q. And is that the document that you
23 identified at the time of your deposition?

24 A. I don't see the \$7.50 so it's not the one
25 that reminded me of the \$7.50 number

1 unfortunately.

2 Q. Well, do you recall --

3 A. But I do recall this document from my
4 deposition, yes.

5 Q. Do you recall trying to do some
6 mathematics with regard to that document to figure
7 out what those figures worked out to on a
8 per-share price?

9 A. I do recall trying to do that in the
10 deposition with you I believe.

11 Q. Yes, you recall that?

12 A. Yes.

13 Q. Your recollection is there was a document
14 that specifically stated the figure of 7.50 a
15 share as opposed to another figure from which
16 you'd have to calculate that?

17 A. I thought you showed me a document at that
18 time that had \$7.50 on it but it may well have
19 just been the one we just looked at.

20 Q. All right. Do you recall at the time of
21 the deposition that you also looked at a letter,
22 an engagement letter from Goldman Sachs?

23 A. Yes.

24 Q. And do you recall some discussion at the
25 time of the deposition about that, sir?

1 A. Yes.

2 Q. And do you recall - well, in the letter do
3 you recall, do you recall in the letter that there
4 were two break points in terms of the fee, if any,
5 that Goldman was to earn?

6 A. Yes, I do.

7 Q. One was at a hundred million and one was
8 at 130 million?

9 A. Yes, I believe that's correct.

10 Q. Do you recall testifying that the hundred
11 million dollars break point was based upon the
12 minimum price based upon the consensus of the
13 board at which the company would be willing to
14 actually sell, sell out?

15 A. No, I don't recall that.

16 Q. You don't recall that?

17 A. No, I'd be happy to look at it to refresh
18 my memory as to what I said the 100 million was
19 based on.

20 Q. Do you recall testifying in your
21 deposition that it was your view as a member of
22 the board of directors that there was not
23 sufficient support at the board level for a sale
24 of this company for less than a hundred million
25 dollars in around the period of September/October

1 1987?

2 A. I don't recall saying that. The reason
3 I'm struggling with that, I'd be happy to look at
4 the deposition, is that it would have been
5 conjecture for me to suggest what the board would
6 have approved I believe as a sale price of the
7 company.

8 THE COURT: Well, did the board
9 discuss the sale of the company in - what date are
10 you utilizing now?

11 Q. This is in the September/October 1987
12 timeframe?

13 THE COURT: In the fall of '87 did
14 the board discuss the value of Staples?

15 A. It did for purposes of valuing certain
16 options, et cetera but in terms of discussing at
17 what price we would be willing to sell the
18 company --

19 THE COURT: Was that ever
20 discussed?

21 A. We did not discuss at what price we'd be
22 willing to sell the company. Mr. Stemberg
23 discussed with us the Sears proposal and said, you
24 know, I don't think we should accept less than
25 7.50 a share or less than whatever the numbers

1 were that he was using. But we did not discuss as
2 board members what we would be willing to sell the
3 company for.

4 The reason I say that is that I
5 know I for one would have been willing to accept a
6 good less. I don't know what each of the other
7 board members would have been willing to accept.
8 But we concurred as to what we should tell Sears
9 we would have been willing to accept.

10 THE COURT: When you say you'd be
11 willing to accept a good deal less, a good deal
12 less than the 7.50 per share?

13 A. Yes.

14 Q. Sir, while we're looking for that
15 reference in your deposition, if I understand then
16 your recollection is that at the time of the
17 events in September and October of 1987 you did
18 not come to the conclusion that there was
19 insufficient support at the board level to sell
20 this company for less than a hundred million
21 dollars?

22 MR. DWORK: I'm sorry, may I have
23 that question.

24 THE COURT: You have a double
25 negative in there. Want to rephrase it.

1 Q. Yes. Now, is it your testimony, sir, that
2 in September and October of 1987 that there was no
3 discussion at the board, among board members as to
4 what was the minimum price that members of the
5 board would be willing to sell the company for?

6 A. I have to be very specific here. We did
7 discuss the minimum price we would be willing to
8 offer the company to Sears for. We never
9 determined what is the minimum price we would
10 actually accept. Although, we certainly would
11 have discussed that.

12 There would have been I'm sure a
13 wide range of viewpoints. And if Mr. Trust, for
14 instance, was on the board he probably would have
15 said I won't take anything less than a very high
16 number.

17 Q. Let's not deal with probabilities. Let's
18 deal with what actually happened.

19 A. Right.

20 Q. That's your testimony that the board, that
21 in the discussions that you had with the members
22 of the board that there was no consensus, if we
23 can put it that way, as to a minimum price to
24 which they would sell or majority at least of the
25 board would agree to sell the company?

1 A. I do not recall selecting the minimum
2 price at which we would sell the company. We may
3 have but I don't recall that.

4 Q. You may have but you don't recall?

5 A. That's right.

6 THE COURT: Let me ask you this
7 question: If you discussed the minimum price you
8 would offer the company to Sears I assume that
9 that's a price you would accept, that is had Sears
10 accepted that offer or had they offered that price
11 let me put it that way, had Sears offered that
12 price, I'm assuming this then - well, I shouldn't
13 assume. Let me ask you had Sears offered the
14 price which apparently they didn't was there a
15 discussion as to whether that would have been
16 acceptable?

17 A. Yes, had Sears returned saying we will pay
18 that price then I am confident that there would
19 have been sufficient support to go ahead at that
20 price. Now, had Sears come back and said --

21 THE COURT: Counteroffer?

22 A. Counteroffer, we'll accept 75. Well, the
23 board surely would have said yes, a hundred was
24 our number. Had they come in with an offer at 75
25 we would have had to have some real sole searching

1 to decide whether we would accept that price.

2 What I'm saying is while we
3 discussed this topic and what the offer would be,
4 what's the right price we could surely sell the
5 company at we never he reached the stage of how
6 low we would actually go. I never considered, for
7 instance, would I go at 75, would I go at 80,
8 would I go at 40, would I go at 50. I never
9 number by number made a decision because my intent
10 was to say what would our bid be and see what we
11 get back.

12 THE COURT: What was that price?
13 I've heard figures now a hundred million, 130
14 million. The 7.50 per share I calculate if, in
15 fact, there were 17 million shares outstanding
16 fully diluted I get 127.5 million.

17 MR. DWORK: If they were fully
18 delighted, Your Honor.

19 THE COURT: Yes, counsel
20 represented that prior to the Class C closing
21 there was approximately 17 million shares on a
22 fully diluted basis outstanding and if that times
23 7.50 I calculate \$127 million, when you say that
24 we discussed the minimum price we would offer the
25 company for sale, what was that price, was it a

1 hundred million or 130 million?

2 A. I believe it was a hundred million was the
3 minimum, was the lowest number I ever can recall
4 us using in any discussions. At some times,
5 however, we used numbers as high as 130 and even
6 higher in our discussions with the company. We
7 would --

8 THE COURT: There was a range
9 between a hundred million and 130 million?

10 A. The lowest number in speaking with
11 potential acquirer we said we want 130 but then
12 there were back-channel communications of, well,
13 you know, it couldn't possibly be less than a
14 hundred. So there were different numbers being
15 used.

16 THE COURT: So the lowest number at
17 least that you as a board member, you can't speak
18 for somebody else but you as a board member, the
19 lowest figure you would have been inclined to
20 accept was a hundred million?

21 A. No, the lowest number that I would have
22 had proposed to offer.

23 THE COURT: The lowest number that
24 you have been inclined to put on the table as an
25 offer was a hundred million?

1 A. That's right. I would have accepted a
2 lower.

3 THE COURT: Was there ever an offer
4 made by Sears or anybody else for those shares to
5 the company?

6 A. No, there was an inquiry back but not an
7 offer.

8 THE COURT: So a hundred million,
9 was a hundred million put on the table at one
10 point?

11 A. No. By us as an offer, yes. But by them
12 as a, you know, we accept that and we'll, you
13 know, that's our bid, no.

14 THE COURT: So a hundred million
15 was put on the table as far as you know to Sears?

16 A. Right, was proposed by us to them.

17 THE COURT: Okay.

18 A. And they came back with a response I
19 believe in March, March or so of '88 with a
20 proposal at around 40 million plus an earn-out
21 provision. And their proposal was in our opinion
22 weak and was tantamount to a fishing expedition on
23 their part to learn more about our business. So
24 we did not pursue it.

25 MR. WALSH: Move to strike the

1 fishing expedition if I may before my brother
2 speaks.

3 MR. DWORK: Okay. I would object
4 on the grounds that it's beyond the period that
5 we're dealing with anyway.

6 THE COURT: That's what I'm trying
7 to find out as to - well, I'm going to still let
8 it in to get an historical perspective as to what
9 was going on in terms of a possible sale of the
10 company. A hundred million then was proposed at
11 some point in time, well, in September of '87, is
12 that fair to say, the fall of '87?

13 A. Yes, we proposed that as a price to them.

14 THE COURT: In the fall of '87 a
15 hundred million was proposed by Staples to Sears.
16 Sears did not accept that figure?

17 A. That's correct.

18 THE COURT: At any time?

19 A. That's correct.

20 THE COURT: As of the fall of '87
21 they made no counteroffer, is that right?

22 A. That's right.

23 THE COURT: There was no
24 counteroffer from Sears or anyone else, is that
25 fair to say?

1 A. That's right.

2 THE COURT: And then at some point
3 in - what was the date, March of '88?

4 A. I don't recall the specifics but some time
5 in the first quarter, I believe it was at the end
6 of the first quarter of '88 they came back with a
7 telephone communication with a different proposal.

8 Q. If I can refer you, sir, to Exhibit No.
9 7. Is that the proposal that you're talking
10 about?

11 A. I didn't actually see the proposal but I
12 discussed it with Mr. Stenberg on the phone. So I
13 could, as I read the proposal here this conforms
14 with my memory of their counterproposal.

15 THE COURT: Does that refresh your
16 memory as to when they came back with it,
17 approximately what date they came back with it?

18 MR. DWORK: May I point out, Your
19 Honor, that's not an exhibit I believe. It's not
20 in evidence. It's premarked.

21 THE COURT: Whether or not it's in
22 evidence you can use it to refresh your memory.

23 A. I really don't recall the date.

24 Q. If I can direct your attention, sir, to
25 the top of Exhibit 7, you see the fax tail there?

1 A. Yes. The fax tail says this was faxed
2 from Dean Witter Rentals on April 18th, 1988.

3 Q. Does that document summarize the proposal
4 that you were talking to His Honor about just now?

5 A. Yes.

6 Q. And you referred to it as a \$40 million
7 proposal, right?

8 A. Yes.

9 Q. And, in fact, sir, the \$40 million was the
10 amount down --

11 MR. DWORK: I'm going to object,
12 Your Honor, as to anything about this proposed
13 transaction on the grounds that it's in April of
14 '88, some two and a half months after the
15 divorce.

16 MR. WALSH: If I may, Your Honor,
17 the trouble I have with that is Mr. Dwork has
18 repeated - has first of all said you can't look at
19 the document and it shouldn't go in evidence
20 because it's outside the period. Then he
21 characterizes it and says it's a \$40 million
22 offer. I think we're entitled to demonstrate that
23 the figures discussed in this were \$40 million
24 down and then earn-out prospectively according to
25 the document up to 150 million.

1 MR. DWORK: I've never represented
2 it as anything, Your Honor, other than that there
3 was some initial preliminary conversation
4 thereafter and never went into it in any more
5 detail than that.

6 THE COURT: Well, I suppose Mr.
7 Walsh is entitled to rebut that assertion that it
8 was only a preliminary inquiry and it was a
9 fishing expedition. He was entitled to
10 demonstrate - I'm going to let you have it.

11 MR. DWORK: Let me point out, Your
12 Honor, that the last paragraph of the first page
13 says, "This proposal is preliminary and subject to
14 further discussions and analysis." That's what it
15 says.

16 MR. WALSH: We'll agree to that,
17 Your Honor. It does say that.

18 THE COURT: Whatever it says it
19 says. I think he's entitled to at least go into
20 it. He's entitled to go in after a full stomach,
21 also. We'll take a luncheon recess now.

22 MR. WALSH: Thank you, Your Honor.

23 (Recess)

24

25 AFTERNOON SESSION

1

2

THE COURT: Mr. Walsh.

3

MR. WALSH: Thank you, Your Honor.

4

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CROSS-EXAMINATION, RESUMED

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Q. (By Mr. Walsh) Mr. Romney, yesterday you went over with Mr. Dwork on the second or the third page actually of this easel some forfeiture restrictions and rights and you had also set them forth on your handwritten report that's now been marked for identification as Exhibit K?

A. Yes.

Q. And it's fair to say, is it not, that in essence what happens is you take these forfeiture provisions and figure out the probabilities of the various events occurring and come to a bottom line which you then attached here as an 80 cent deduction from the common for Tom's so-called forfeiture restrictions, is that fair to say?

A. Yes and no. No to the extent that my assessment was that Tom's stock had no value because of those forfeiture provisions that you looked on.

But for purposes of a theoretical

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1 statistical calculation as to the discount which
2 would be applied I used those assessed
3 probabilities and arrived at the 80 cents.

4 Q. That's how you arrived at it, isn't it?

5 A. To the 80 cents but my testimony, however,
6 was that the value of his securities was nil.

7 Q. Well, we're just talking about how you got
8 to the forfeiture restriction and that price, you
9 got to it by doing the probability analysis and
10 then carrying that part over and listing it as an
11 80 cent deduction, right?

12 A. We're maybe ships passing here. The 80
13 cents you have there, yes, was calculated on a
14 statistical basis but my testimony was that his
15 stock did not have value irrespective of the 80
16 cents. The 80 cent calculation I did to go beyond
17 my conclusion of lack of market value but to find
18 a statistical way of finding something of a
19 positive value.

20 Q. Is that because in your view no one would
21 buy Mr. Stemberg's stock?

22 A. It's in my view that no sophisticated
23 investor would buy Mr. Stemberg's stock, perhaps a
24 speculator, I think I used the term yesterday.

25 Q. Or a gambler?

1 A. Or a gambler would be willing to buy the
2 stock. And if so the methodology I applied here
3 would be the basis that such an investor would
4 consider such an action.

5 Q. You came to the conclusion that Mr.
6 Stemberg's stock was worth zero in either event,
7 either by applying your probability analysis and
8 deducting this 80 cent forfeiture right or
9 independently on the basis that in your view a
10 sophisticated investor would never buy his stock
11 anyway, is that fair to say?

12 A. Yes and no. The value I had as you recall
13 following the statistical analysis was zero to 40
14 cents. So it was not zero but it was a, the net a
15 positive number. So that methodology ended up
16 with a positive number of approximately zero to 40
17 cents whereas the other methodology said no
18 sophisticated investor would acquire Tom's
19 securities and, therefore, their value would have
20 been zero.

21 So come up with two answers: The
22 sophisticated investor answer which is zero, a
23 statistical probablistic answer which is zero to
24 40 cents.

25 Q. In fact, sir, with respect to the

1 sophisticated investor, that's the whole way these
2 stock deals are structured, isn't it, for the very
3 purpose that no one will want to buy them and no
4 one will want to sell them?

5 A. That's correct.

6 Q. That's the object, isn't it?

7 A. No, that's not the object.

8 Q. Well, one of the objects is to make it
9 sufficiently painful to the chief executive can
10 officer to transfer his stock so that he won't
11 want to do that?

12 A. So that he won't want to leave the company
13 is the reason.

14 Q. Sure. That's because you want to keep
15 him?

16 A. That's correct.

17 Q. You want to keep his nose to the
18 grindstone so he can make more money?

19 A. Exactly.

20 Q. For the company and for you?

21 A. That's correct.

22 Q. That's the idea of it?

23 A. That's correct.

24 Q. The real value in the stock is to hold the
25 stock rather than to sell?

1 A. That's correct.

2 Q. And to hold it for the future?

3 A. That's correct.

4 Q. That's the whole reason you structure
5 deals the way you do, right, or one of the major
6 reasons?

7 A. Yes.

8 Q. The other major reasons being that you
9 want to make sure that, in fact, he doesn't leave
10 and that you do have his services, right?

11 A. That's correct.

12 Q. Now, just dealing with the forfeiture
13 analysis or the probability analysis I should say,
14 if I understand what you did you took a series of
15 events - I wonder, does The Court have in front of
16 him the handwritten --

17 THE COURT: L for identification.

18 MR. WALSH: Yes.

19 THE COURT: I have it, thank you.

20 Q. Page 2. Sir, if I understand what you did
21 you listed six or actually seven different events
22 that could occur that might in some way involve
23 one of the forfeiture restrictions, right?

24 A. That's correct.

25 Q. And then I believe we agreed that you'd

1 strike the death event because by the time of this
2 valuation that restriction was already gone, it
3 had already lapsed, right?

4 A. That's correct.

5 Q. Now, of the remaining restrictions you had
6 three different types of events involving a
7 firing, you had one for cause before 1988, January
8 of 1988, then you had one without cause again
9 before then and then you had one that was lumped
10 together, it was fired and it didn't break it down
11 as to whether it was for cause or without cause?

12 A. It meant it was for either.

13 Q. It was for either?

14 A. Right.

15 Q. And that was for the period beginning in
16 January of '88 and going to January of 1990,
17 right?

18 A. That's correct.

19 Q. And within that one, sir, could you break
20 that down for us as to what the probability was
21 that Mr. Stenberg would be fired for cause within
22 that period and the probability that he would be
23 fired without cause within that same time period?

24 A. The - what would you like me to do? You
25 would like me to retain the probabilities for

1 cause and without cause?

2 Q. Yes. It's this one, this final fired with
3 or without cause between January of '88 and
4 January of 1990, could you break that down for us
5 as to the different probabilities depending upon
6 whether it was with cause or without?

7 A. Yes.

8 Q. What is the probability that he would be
9 fired with cause first?

10 THE COURT: Between those dates?

11 Q. Yes, in that time period, yes.

12 A. It's going to take a little thinking to,
13 for me to split the probabilities I had reached in
14 my previous consideration which, as you'll note,
15 on the page I had firing with or without cause
16 during that two-year period as being on the high
17 side, about a 33 percent probability and on the
18 low side about a 20 percent probability.

19 Q. That's right.

20 A. If you ask me to split those in two I need
21 to, I will give you a preliminary answer because
22 we don't have the time for me to dwell on this for
23 a half hour. But let me indicate first that I
24 think the likelihood he would be fired without
25 cause would be much higher than he would be fired

1 with cause.

2 And I would assess on the high
3 probability side, if I were dividing that 33
4 percent just on a simple arithmetic basis I would
5 divide that with perhaps a 6 percent chance or
6 let's say a 5 percent chance of being fired for
7 cause and if I'm just going to subtract the 5 from
8 33 for a moment, then a 28 percent chance of being
9 fired without cause.

10 And if I turned to the low range
11 which is my 20 percent total I would split the,
12 for cause low side case as perhaps say 2 percent
13 probability and that would leave an 18 percent
14 simple arithmetic subtraction for the fired
15 without cause.

16 Q. And looking at that are you satisfied that
17 those percentages are approximately right having
18 in mind that you've now lived through those
19 events, in fact, does it appear to you to be about
20 right?

21 MR. DWORK: I pray Your Honor's
22 judgment. The fact that he lived through those
23 facts should be disregarded, not regarded.

24 Q. All right, that's fair. I'll strike
25 that. Looking at those percentages, sir --

1 THE COURT: Only thing would be
2 regarded I suppose would be zero percent.

3 Q. That's right, fair enough. Looking at
4 those percentages does it appear to you that
5 that's approximately the range, that it would be
6 somewhere around 5 percent for cause on the high
7 probability and the balance for without cause?

8 A. That's correct. That's order of magnitude
9 the right split.

10 Q. Now, with regard to what you actually did
11 on, I don't think you can really tell on this
12 chart but on your original note, sir, what you did
13 I think is you grouped together on the forfeiture
14 those events which involve first of all a 100
15 percent forfeiture right, correct?

16 A. That's correct.

17 Q. So you took the 1 percent of line 1 "quits
18 before 1988," right?

19 A. Yes.

20 Q. And added to it "fired for cause before
21 January of '88," right?

22 A. You say - oh, fired, yes, I'm sorry.
23 Fired, yes.

24 Q. Then added to that "competes before
25 January of 1990"?

1 A. Correct.

2 Q. And you grouped those three and added them
3 up and under the high probability that gave you 8
4 percent?

5 A. That's correct.

6 Q. And then under the low probability I guess
7 you got about 5 percent?

8 A. That's correct.

9 Q. And those are the figures that you then
10 had under those two columns first?

11 A. That's correct.

12 Q. So where it says 8 percent equals zero
13 what you did was that was 8 percent, it was an 8
14 percent probability in your view that he'd end up
15 with zero shares?

16 A. That's correct.

17 Q. And then what you did was you took the 50
18 percent probabilities or the events which would
19 trigger a 50 percent forfeiture, right?

20 A. Yes.

21 Q. And you added those up as well?

22 A. That's correct.

23 Q. And that gave you 10 percent for quitting
24 before January of '90 and then 10 percent for
25 being fired without cause before January of '88,

1 right?

2 A. Yes.

3 Q. And then 33 percent for being fired in the
4 period of '88 to '90?

5 A. That's correct.

6 Q. And that gave you your 53 percent?

7 A. That's correct.

8 Q. Which you then multiplied out times 50
9 percent because that represented 50 percent of
10 what Mr. Stemberg would end up with if one of
11 those events occurred?

12 A. That's correct.

13 Q. Okay. So what you did, sir, was you added
14 the probabilities up, right?

15 A. That's correct. What I did was seeking a
16 weighted average a number of shares Tom Stemberg
17 would have.

18 Q. That's right you arrived at that by adding
19 up the probability first on the high side for 100
20 percent forfeiture, right?

21 A. Yes.

22 Q. And then the same thing for 50 percent
23 forfeiture?

24 A. That's right.

25 Q. Now, if we look, sir, in the event Mr.

1 Stemberg quit, the first event, before January of
2 1988, in that event he would not be fired, would
3 he, in the period after January of 1988?

4 A. That's correct.

5 Q. And similarly, sir, in the event that he
6 competed that in and of itself as you negotiated
7 Mr. Stemberg's contract would have meant that he
8 was going to be fired for cause, right?

9 A. That's correct.

10 Q. So, in fact, sir, a number of these events
11 that you have here are, in fact, mutually
12 exclusive of one another, aren't they?

13 A. All of the events I believe are mutually
14 exclusive. It's not likewise, the one that is not
15 mentioned here, that he stays, is mutually
16 exclusive from the others as well.

17 Q. So if he quits before January of 1988
18 you're not going to get into the analysis of
19 what's going to happen in the period of '88 to
20 '90, right?

21 MR. DWORK: Objection, Your Honor.
22 If he quits we know what happened. He's measuring
23 what might happen and what the probabilities of
24 each of the things happening.

25 THE COURT: I think what he's

1 saying is that if any one event happens then the
2 rest are moot.

3 MR. WALSH: That's right.

4 THE COURT: Quit, if he's fired, if
5 he competes.

6 MR. DWORK: That's right but the
7 alternatives are not mutually exclusive. But we
8 know only one of them will occur but the
9 alternatives are all there. If you know you're
10 going to die in 1990 by drowning, stabbing or
11 tuberculosis it's only a one-third chance of each
12 but it's a hundred percent chance of dying.

13 THE COURT: Well, it's
14 cross-examination but I think Mr. Dwork's point is
15 well taken. If it's 5 percent likelihood, for
16 argument sake, he's going to quit and 5 percent
17 he's going to compete and 5 percent he's going to
18 do something even though they're all mutually
19 exclusive it seems to me that you're entitled to
20 total them up and say that the likelihood is 15
21 percent that one of these events will occur. It
22 will only be 5 percent - what he's done - he's
23 agreeing with you they're mutually exclusive but
24 he's saying we don't know which event is going to
25 occur and he's adding up any percentages. I don't

1 see any problem with that frankly. They're all
2 mutually exclusive.

3 Q. They are all mutually exclusive, right?

4 A. Yes, they are.

5 Q. In fact, sir, under your usual probability
6 analysis - by the way, when you make an investment
7 do you do one of these probability analyses
8 typically?

9 A. Yes.

10 Q. You do?

11 A. Yes. But typically we don't do a
12 probability analysis on the future of the company.
13 I do not do not do a probability analysis on the
14 likelihood of the departure of a chief executive
15 officer based upon as detailed an outline as you
16 have here. I typically, I typically begin in a
17 company with a 50/50 probability that a chief
18 executive officer will remain in the company.

19 Q. In terms of this particular analysis, sir,
20 instead of adding these various probabilities up,
21 the 1 percent, the 2 percent and 5 percent,
22 wouldn't you agree that they should be multiplied?

23 A. No.

24 Q. You don't think they should be multiplied?

25 A. You'll find that if you use any of two

1 methods of determining the weighted average number
2 that they result in the same number as I have used
3 a shorthand method of achieving weighted average
4 value. But if you multiply them the, 100 percent
5 times the 1 percent and add those up you'll come
6 up with the same number.

7 Q. I see. So in your view it will make no
8 difference whether we add them or we do the
9 multiplication?

10 A. It depends on what numbers we're
11 multiplying I guess.

12 Q. Assuming that we are either adding or
13 multiplying the same numbers that you have on this
14 page?

15 A. You'll have to tell me which two numbers
16 we're going to multiply to create an answer so I
17 can tell you whether that's going to be the same
18 as the addition.

19 Q. Let's just take the first three under the
20 high probability involving a hundred percent
21 forfeiture. That would be the 1 percent figure,
22 the 2 percent figure and the 5 percent figure.

23 A. Yes.

24 Q. And you added those up, right?

25 A. Yes.

1 Q. And in this particular instance it's your
2 view that if you multiplied them you'd still come
3 to the same number?

4 A. If I multiplied what I'd --

5 Q. Those same numbers.

6 A. Which same numbers?

7 Q. The 1 percent, 2 percent, 5 percent.

8 A. If I multiplied 1 by 2 by 5?

9 Q. Yes.

10 A. No I'd never multiply and that would not
11 come up with the same answer. If I multiplied 1
12 times 100, 2 times 100, 5 times 100 and added the
13 product together I would arrive at the same
14 conclusion.

15 Q. Okay. Now, you testified in your
16 deposition, didn't you, sir, that in applying the
17 forfeiture analysis that you chose to rely on the
18 mathematical method because you believed, that you
19 chose to rely on the mathematical method as
20 opposed to trying to sort of figure out in your
21 own mind how much you would pay as an investor?

22 MR. DWORK: Could you have --

23 A. If you'll show me the page I'll respond to
24 that. What I testified in the court yesterday was
25 that --

1 Q. No, this is in your deposition, I'm sorry,
2 sir.

3 A. Okay. Clearly in reaching - maybe this
4 will solve it. In reaching the 80 cent number I
5 relied upon this methodology.

6 Q. Yes.

7 A. In reaching the 80 cent discount number I
8 used this methodology, yes.

9 Q. And not your subjective number, right?

10 A. That's correct.

11 Q. And while you were at the board of
12 directors, a member of the board of directors and
13 investor in the company did Mr. Stemberg ever say
14 that he intended to quit?

15 A. If you'll repeat the question, please.

16 Q. Yes. While you were a member of the board
17 of directors or an investor in the company did Mr.
18 Stemberg ever say that he would quit?

19 A. Yes.

20 Q. Did he say he would quit at what time?
21 When did he make the statement first of all?

22 A. He made the statement very early on that
23 he did not, and I don't know how soon, '86, '87
24 that he did not intend to remain as the chief
25 executive of the company indefinitely and at the

1 time we began our search for a chief operating
2 officer he indicated that he anticipated that this
3 chief operating officer would be someone who would
4 take his place ultimately.

5 THE COURT: As CEO?

6 A. As CEO. And but there was not a time
7 where he said, you know, I quit or I'm about to
8 quit or something of that nature. We instead
9 planned for his departure from the company.

10 Q. That was part of your normal planning
11 process, right?

12 A. That's correct.

13 Q. But he didn't in a huff or anything say
14 I'm about to quit now?

15 A. That's correct.

16 Q. And you understood that with regard to the
17 planning it was your expectation at least that Mr.
18 Stenberg was going to stay at least to the IPO or
19 sale of the company?

20 A. It was my understanding that he would like
21 to have stayed during that period, that was his
22 present intention.

23 Q. You didn't expect that he was going to
24 quit before those dates?

25 A. I didn't give it a high probability but I

1 didn't dismiss it as being impossible.

2 Q. And as a matter of fact, had he quit he
3 would have forfeited all his stock, right, at
4 least if he had done it before January of 1988?

5 A. That's right.

6 Q. And had he done that he would have missed
7 out on the run-up in the stock that was predicted
8 by the company at that point?

9 A. That's correct.

10 Q. And assuming the 7.50 a share price for a
11 minute that would have meant a loss to him of
12 somewhere in excess of \$10 million had he quit?

13 A. Assuming the 7.50 a share price, that's
14 correct.

15 Q. And so you didn't have any expectation he
16 was going to do that voluntarily, did you?

17 A. I did not. I gave it a 99 percent
18 probability that he would not do that.

19 Q. And with respect to the firing for cause,
20 sir, were you aware of any facts or circumstances
21 giving rise to a right to fire Mr. Stemberg for
22 cause either in September of 1987 or through
23 January of 1988?

24 A. There was extensive negotiation about what
25 for cause meant in our original employment

1 contract. Typically in those contracts we are
2 negotiated to a position where for cause means
3 theft or major embarrassment of the company, some
4 malicious acts.

5 In this case we negotiated a much
6 broader for cause provision as I recall. And that
7 was done such that we would be able to construct
8 if we needed to an argument that he was being
9 fired for cause. I do not recall the specific
10 circumstances which would have led to that at this
11 point.

12 We had not commenced an
13 investigation prior to September of '87 to see
14 whether he had performed any act which would have
15 violated the for cause provision and I knew of
16 none at that point.

17 Q. So I think the answer to my question then
18 is you knew of no facts and circumstances in the
19 period of September 1987 to January of 1988 giving
20 rise to cause to fire Mr. Stemberg?

21 A. That's correct.

22 Q. And, in fact, sir, no such facts or
23 information came to your attention for the next
24 period, the period January of 1988 to 1990?

25 MR. DWORK: Well, I object to that,

1 Your Honor.

2 THE COURT: How would that be
3 relevant?

4 MR. WALSH: In terms of the
5 forfeiture right, Your Honor, and probability.
6 The probability that would occur is certainly I
7 think weighed by what in reality did.

8 THE COURT: You can have it. I'll
9 let you have it. He's used those dates and
10 those --

11 MR. DWORK: Do I understand what
12 he's asking is did they find out in 1990 about any
13 wrongdoings in the earlier period, is that what
14 the question is?

15 MR. WALSH: I think so, yes.

16 A. The question is do I know now of anything
17 he did between 1988 and 1990 that would have
18 allowed us to fire him for cause?

19 Q. Yes.

20 A. I don't.

21 MR. DWORK: I renew my objection,
22 Your Honor, as being beyond the time when that was
23 pertinent to our problem.

24 A. Yes, I don't know.

25 THE COURT: I understand that it's

1 beyond the time in terms of whether or not his job
2 was actually in jeopardy at the time of the
3 negotiations but I think counsel is seeking to use
4 this testimony to somehow get into his probability
5 analysis so I'm going to let you have it.

6 MR. WALSH: Thank you.

7 THE COURT: Some of the factors
8 that would divest him of some portion of his stock
9 occurred after '87 and '88 and so on, is that what
10 you're relating to?

11 MR. WALSH: Yes, Your Honor.
12 Exactly.

13 THE COURT: For that limited
14 purpose you can have it.

15 A. Actually by the benefit of hindsight none
16 of the events listed here occurred.

17 Q. You know even sitting here now of no facts
18 and circumstances giving rise to cause to fire in
19 that period, right?

20 MR. DWORK: Renew my objection,
21 Your Honor, on the same grounds that he found out
22 that Tom had performed his job. Doesn't change
23 what the valuation would have been for somebody
24 sitting in September 1987.

25 THE COURT: I understand what

1 you're saying but I think perhaps what he's doing
2 is challenging his probability factors.

3 MR. WALSH: That's right.

4 MR. DWORK: Or the fact that Tom
5 turned out to be honest doesn't change the
6 probability of Tom being honest or not.

7 THE COURT: I'm going to overrule.
8 You can have it but I think we spent enough time
9 frankly on these probability factors. I mean if
10 you're going to go into every factor of the
11 probability of what happened and not happened we'd
12 be here forever. I think it's really time to move
13 on.

14 Q. All right. Sir, did anybody ever say in
15 your hearing or suggest in your hearing that Mr.
16 Stemberg ought to be fired?

17 A. No one said that Mr. Stemberg ought to be
18 fired that I can recall.

19 Q. In fact, did anybody say in your hearing
20 that Mr. Stemberg was not the right person for the
21 job of CEO?

22 THE COURT: What point in time are
23 you now referring to?

24 Q. Well, let's stick with the period before
25 January of 1988.

1 THE COURT: Between September of
2 '87 and January of '88?

3 Q. Yes, or before.

4 A. There were extensive discussions
5 suggesting that Mr. Stemberg may not be the right
6 chief executive, yes.

7 Q. And those discussions were related to the
8 Hardyman dispute and the Adler dispute, were they
9 not?

10 A. Among other things that I listed yesterday
11 as to the discussions relating to Tom's ability to
12 be chief executive those were two of the ones I
13 listed yesterday.

14 Q. Well, did you say in your deposition at
15 page 58 of I think the second volume, "There were
16 complaints about Tom's performance but did people
17 actually say in my hearing that Tom ought to be
18 removed or that he may not be the right guy, I
19 don't recall any discussions of that nature.

20 "Question: At any time, is that
21 fair to say?

22 "Answer: At any time prior to
23 January of 1988."

24 Was that your testimony on that
25 occasion?

1 A. If you're reading from the record it is.

2 Q. Now, you talked about the negotiations
3 that led to this agreement, sir, which at least in
4 part you conducted on behalf of the company,
5 right?

6 A. Which agreement?

7 Q. Mr. Stenberg's restriction agreements.

8 A. Oh, yes.

9 Q. And employment agreement, in fact, right?

10 A. That's correct.

11 Q. Now, you indicated that those terms were
12 highly negotiated yesterday and that some points
13 you won, in some points Tom won, do you recall
14 that testimony?

15 A. Yes.

16 Q. With respect to the terms governing
17 discharge without cause, did you negotiate that
18 directly with Mr. Stenberg or was that something
19 done by Mr. Samuels?

20 A. I don't recall. It was clearly something
21 that I would have discussed with Tom and with his
22 attorney and Mr. Samuels would have discussed with
23 Tom and his attorney. We all participated
24 extensively in those discussions and negotiations.

25 Q. And did you particularly negotiate that

1 term on behalf of the company, that is the term
2 regarding the circumstances under which Mr.
3 Stemberg, if any, could be discharged without
4 cause?

5 A. I'm sorry, I don't recall whether I
6 specifically led the discussion or whether Mr.
7 Samuels did at this stage.

8 Q. With respect to the outcome of that
9 negotiation, sir, did you ultimately reach an
10 agreement with Mr. Stemberg that the only noncause
11 reason for his discharge would be if he became
12 disabled?

13 A. No, not that I recall. Noncause?

14 Q. That's right.

15 A. No.

16 Q. Well, if I can direct your attention, sir,
17 to Exhibit 28 page 6 paragraph 8 titled
18 "Termination of employment: Effective
19 termination." First paragraph lettered A speaks
20 about termination by his death, right?

21 A. Yes.

22 Q. And then goes on to say that the company
23 can terminate Mr. Stemberg upon written notice
24 upon the occurrence of either of the following
25 events and then lists, 1, disability of the

1 executive as defined in subparagraph B, right?

2 A. Yes.

3 Q. And then 2, the determination that there
4 is cause as hereinafter defined?

5 A. Yes.

6 Q. For such termination, right?

7 A. Yes.

8 Q. And then the next paragraph B defines
9 disability, correct?

10 A. Yes.

11 Q. Relating to illness, physical or mental
12 incapacity, things like that?

13 A. Right.

14 Q. And then the next paragraph defines cause,
15 right?

16 A. That's right.

17 Q. So having looked at that, if you care to
18 look at the rest of it, does that refresh your
19 recollection as to the negotiations over the
20 provisions regarding Mr. Stenberg's termination
21 for or without cause?

22 A. Not very well but it does a little bit but
23 not much. Basically I think if you continue
24 reading there and as you clearly, a company can
25 fire an employee other than for disability and

1 cause. If he's not performing one can fire that
2 employee and it would not be for cause; it would
3 be without cause.

4 Q. In fact, the way you negotiated this
5 agreement, sir, if he's not performing his duties
6 that is cause, right?

7 A. If he's not performing his duties as
8 directed by the board that would be cause.

9 Q. Sure. And that's how it's defined here,
10 right?

11 A. Yes.

12 Q. That's not a without cause termination, is
13 it, as you negotiated it?

14 A. In the terms of that agreement I would
15 actually need an attorney to tell me which
16 provision we would fire him under. It depends on
17 the particular act he would have committed.

18 Q. You are an attorney, aren't you?

19 A. As I mentioned I went to law school. I
20 haven't practiced.

21 Q. I see. You're not admitted anywhere?

22 A. I am an admitted member of the bar of the
23 State of Michigan.

24 Q. Oh, all right. Now, when you testified
25 yesterday you also mentioned a ten-to-one ratio,

1 didn't you, as being a sort of a rule of thumb on
2 something in the industry, ten-to-one ratio
3 between the price of preferred to common?

4 A. At the time of initial start-up, yes.

5 Q. And thereafter typically as you go to an
6 IPO I think you indicated that gap narrows and
7 ultimately becomes zero?

8 A. Correct.

9 Q. And, in fact, I think you said in your
10 deposition, didn't you, that that price can
11 actually be as much as a hundred to one ratio
12 ultimately narrowing to zero or one to one?

13 A. That's correct.

14 Q. On the day of the IPO. And in the
15 analysis that you did for us, sir, it's true, is
16 it not, that the ratio from preferred to common as
17 you outlined it here was actually about two to
18 one?

19 A. Depending on which range, yes. But it's
20 close to two to one, that's right.

21 Q. So that's at the point just before the
22 IPO, isn't it, as you defined it?

23 A. When you say "just before the IPO" --

24 Q. Shortly before.

25 A. No. It is at the level of risk of the

1 company. At the time I evaluated it I considered
2 the level of risk to be substantially smaller than
3 at the time we made our first investment and,
4 therefore, the range was much closer.

5 Q. Sure much closer than the one-to-one
6 ratio, right?

7 A. Yes, two or three to one is a lot closer
8 than ten to one.

9 Q. And not the ten to one that you typically
10 get for a start-up company?

11 A. That's right.

12 Q. And as a matter of fact, it was your
13 belief, was it not, that this particular company
14 at the time of the round C in September of 1987
15 was on the "track of success"?

16 A. Will you rephrase the question again. Did
17 I testify that the company was on the track of
18 success?

19 Q. Yes.

20 A. It may have been on the track but it
21 diverted a good deal. So there were a number of
22 problems in the company which gave us great
23 concern but it was making progress. Maybe we can
24 look at the specific quote but I --

25 Q. Such great concern that you invested how

1 much money in September?

2 MR. DWORK: September of '87?

3 Q. September of '87.

4 A. Right. It was certainly of a value in my
5 opinion worth \$2.90 a share. And had the company
6 been in a perfect record, had it met any one of
7 its plans which it did not but had it met its
8 plans the value would have been probably higher
9 than that or if the price would have been 2.90 I
10 would have.

11 Q. Isn't it true that the plans were
12 continually being changed?

13 A. Yes.

14 Q. In fact, are continually being changed to
15 add additional stores?

16 A. They were continually being - I don't
17 believe they were being changed to add stores as
18 much as they were being changed to reflect losses
19 and more cash being needed.

20 Q. That's all? They weren't adding stores?

21 A. I'm sure they were adding stores as well.

22 Q. In fact, isn't it true that there were
23 several stake in Staples shareholder letters that
24 were issued during this time period talking about
25 how the company had to accelerate its business

1 plan?

2 A. I don't believe those, the stake in
3 Staples letters went to employees and I don't
4 recall the stake in Staples letters but there is
5 no question but that we accelerated the rate of
6 growth of our stores and we also had
7 disappointment from an earning in cash debt point.

8 Q. The disappoint the from the earning in the
9 cash standpoint was because you were opening more
10 stores more quickly than had previously been
11 thought or planned?

12 A. That was one of the reasons.

13 Q. A second reason was because you were now
14 opening a central distribution warehouse in
15 Putnam, Connecticut, right?

16 A. Yes.

17 Q. And the board voted for that, didn't it?

18 A. It certainly did.

19 Q. And it knew when it voted for it that that
20 was going to have an impact upon earnings?

21 A. Exactly.

22 Q. To the negative, in fact?

23 A. Exactly.

24 Q. As a matter of fact, that was one of
25 Adler's complaints, wasn't it?

1 A. Yes, it was.

2 Q. He didn't want that because he wanted this
3 company to move quickly to an IPO?

4 A. Yes.

5 Q. That was what he said?

6 A. It was still a big disappointment. We
7 voted for a distribution certainty but we were not
8 happy that this was not part of our plan and that
9 we had to spend that kind of money.

10 Q. Well, didn't you agree with Mr. Stemberg's
11 judgment when you voted for it that, in fact, what
12 this would do was be unique in your business?

13 A. It would be unique in our business, yes.

14 Q. And that it would give Staples a
15 competitive leg-up against other companies?

16 A. Yes, we believed that.

17 Q. And that's the reason why you did it, a
18 short-term loss for long-term gain, right?

19 A. We believed it was in the best interests
20 of the company to do this, that's right.

21 Q. As a result the business plan, in fact,
22 was altered again to increase projected sales
23 around April of 1987, wasn't it?

24 A. I'm sorry, I can't recall the specific
25 times business plans were adjusted but I have

1 copies and I presume the company has copies of the
2 business plans and you could refer to that. But
3 the sales projections would, I would not be at all
4 surprised to see sales projections increase and
5 earnings projections decrease.

6 Q. And earnings projections decrease for how
7 long, sir?

8 MR. DWORK: Is that question? Did
9 or would?

10 Q. Decreased for how long?

11 MR. DWORK: Well, could we have the
12 question again, Your honor.

13 THE COURT: Are you able to read
14 that back.

15 (Questions and answer read)

16 MR. DWORK: I think you have to
17 have a beginning period of time, Your Honor, to
18 answer that question, otherwise it doesn't make
19 sense.

20 Q. That's what I was asking from the witness,
21 when he made the statement what period was he
22 looking at.

23 A. We were as board members and I in
24 particular was disappointed with the results of
25 the company. The plans showed the disappointing

1 results now being actual and they were off what
2 our budget had been and new budgets were prepared
3 which showed losses where we had anticipated
4 originally to have gains.

5 Over what period of time?
6 Typically the disappointment was only short term
7 and long term. The forecasts were always for
8 things to be at least as good as Tom had
9 originally forecast.

10 Q. And, in fact, the sales projections were
11 actually higher, were they not, than Tom had
12 originally forecast?

13 A. I don't recall but that's very possible.

14 Q. Well, do you know Ed Goodman?

15 A. Yes.

16 Q. Have you ever read his investment
17 opportunity summary that he gave to his investors?

18 A. No.

19 Q. By the way, you don't have an investment
20 opportunity memo or any such document, do you?

21 A. That's correct.

22 Q. For the round C or the round B?

23 A. Or any round.

24 Q. Or any round. Typically I think what you
25 said you did is you did some kind of a slide show

1 or something?

2 A. That's right. We make a slide
3 presentation to discuss the merits of an
4 investment.

5 Q. So we don't have copies of what you told
6 your investors at the time of the round B or the
7 round C, do we?

8 A. That's correct.

9 Q. Now, with regard to the, would you agree
10 with the statement that in the fall of 1987 stores
11 were taking somewhat more time to ramp up but were
12 going to higher sales projections than had been
13 expected?

14 A. No.

15 Q. You would not?

16 A. No.

17 Q. Now, you told His Honor yesterday that
18 there were some studies about venture capital
19 groups that you were familiar with, I think CIGNA
20 was one of them that indicated an 8 to 12 percent
21 return is typical of venture capital firms?

22 A. I believe I said hi single digits to
23 teens. So I would run that from 7 to perhaps 14
24 or 15 percent rate of returns for funds raised
25 between 1983, '84 and '85.

1 Q. And would you consider your fund to be one
2 such fund, a fund like they described?

3 A. Yes.

4 Q. And so has it been your experience in your
5 fund that you started in 1984 that ultimately you
6 show a rate of return of between 7 and 14 percent?

7 A. No. We do a good deal better than that.

8 Q. One of the reasons you did better than
9 that was your investment in Staples, isn't it?

10 A. That's correct.

11 Q. What is your rate, sir, that you've
12 experienced?

13 A. We have two rates of return: One is based
14 on our venture of an investor, the other is based
15 on our LBO investing or leveraged buyout
16 investing.

17 Q. I think the articles that you were citing
18 to us dealt with venture capital firms, didn't
19 they?

20 A. That's correct.

21 Q. Let's stick with that. What's your rate
22 on the venture capital investment?

23 A. The venture capital would be approximately
24 30 percent but to give you an accurate number I
25 would need to have that calculated. The total

1 return on our fund is in excess of 70 percent.
2 And that's due to very high rates of return in the
3 acquisition or LBO investment area.

4 Q. So your fund is, therefore, not typical of
5 other venture funds that you were talking about
6 yesterday?

7 A. Not in terms of its success.

8 Q. Now, I think you said that Mr. Stemberg
9 had discussed with you the Adler dispute at some
10 point in time, did you testify to that yesterday?

11 A. Yes, I did.

12 Q. And the Adler dispute was, ultimately was
13 caused, was it not, by Mr. Adler's investment in a
14 competing company?

15 A. That was the genesis, that was the
16 beginning of the end so to speak in that dispute.

17 Q. And that was what triggered the dispute
18 between Adler and Stemberg, et al, right?

19 A. There's no question that got the
20 relationship off to a rocky road. The dispute
21 moved on to one of Tom's capability to run the
22 business properly.

23 Q. So first what we had was Mr. Adler
24 invested in it was Office Depot, wasn't it, that
25 he invested in?

1 A. We believe, we had reports that he
2 invested his children's trust money through a
3 friend in Office Depot, yes.

4 Q. And he did that, sir, according to your
5 information some time in September or so of 1986,
6 isn't that so?

7 A. I don't know when the timeframe was but I
8 believe it was in September of '86 or in that
9 general time that I heard about that investment.

10 Q. Okay. And so Mr. Stemberg found out about
11 it around that same period of time as did you,
12 right?

13 A. I found out as soon as he did and I
14 presume it was around that time.

15 THE COURT: Let me ask you how
16 would anyone have learned of such an investment?
17 Presumably Mr. Adler didn't disclose it.

18 A. No, the executives at Office Depot were
19 telling people who they were trying to raise money
20 from that the lead investor in Staples had
21 invested in them with his own personal money. And
22 that was the genesis of the rumors is that they
23 were touting their stock by saying that our lead
24 investor was investing in them.

25 THE COURT: Touting their stock to

1 venture capitalists, competing venture
2 capitalists?

3 A. Yes, right. I don't recall specifically
4 how Tom first heard of it but I presume it was
5 from a venture capitalist that was also looking at
6 Staples.

7 Q. As a result once you and Mr. Stemberg
8 learned of it that began an acrimonious
9 relationship with Mr. Adler and Mr. Stemberg,
10 didn't it?

11 A. Yes.

12 Q. And thereafter Mr. Adler complained about
13 everything, didn't he, that Mr. Stemberg did?

14 A. He complained about a number of things but
15 not everything.

16 Q. Well, for the most part he complained
17 about most of the things that he did, didn't he?

18 A. I wouldn't say he complained about most of
19 the things Tom Stemberg did but several major
20 decisions he disagreed with and complained about.

21 Q. Did you think that Mr. Stemberg in the
22 period of 1986 and 1987 was doing a good job?

23 A. Yes.

24 Q. And you thought he was capable
25 financially?

1 A. Yes.

2 Q. A sound and capable manager?

3 A. Yes.

4 Q. When you told His Honor about going to
5 meet Mr. Adler to discuss with him the error of
6 his ways as you saw it the upshot of it was that
7 you went there with the board, support of the
8 board, did you not?

9 A. I believe so but I don't recall whether
10 the board discussed my visit to Mr. Adler. We
11 certainly discussed what we should do with Mr.
12 Adler and in the whole setting but I don't recall
13 if we had discussed it prior to my visit or
14 whether we discussed it after the visit. I don't
15 recall the timeframe.

16 Q. Is it fair to say that at some time
17 shortly after Mr. Stenberg learned that, at least
18 he believed that Mr. Adler had invested in a
19 competitor that he undertook an effort to try to
20 have Adler thrown off the board?

21 A. Yes.

22 Q. And he undertook that effort with the full
23 support of several board members, isn't that so?

24 A. That's correct.

25 Q. Including yourself?

1 A. That's correct.

2 Q. And ultimately, sir, Mr. Adler was or his
3 representative Mr. Samuels was removed from the
4 board?

5 A. That's correct.

6 Q. And, in fact, there came a time, did there
7 not, in approximately the summer or early fall
8 1987 when Mr. Samuels, Mr. Adler's board
9 representative was closed off from any further
10 confidential information concerning the company?

11 A. I don't recall the specific timeframe but
12 there was a time when we restricted the
13 information Mr. Samuels received out of a concern
14 that it was being taken to Office Depot.

15 Q. And that was done again with the support
16 of the board, right?

17 A. That's correct.

18 Q. And so after the dispute, as a matter of
19 fact, didn't you say that Mr. Stemberg's
20 suggestions, all of his suggestions were disagreed
21 with by Mr. Adler during the period 1987?

22 A. That would be an overstatement to say that
23 all of Mr. Stemberg's suggestions were disagreed
24 with by Mr. Samuels or Mr. Adler. But certainly a
25 number of important of his suggestions were

1 disagreed with, specifically the distribution
2 center, his selection of managers. There may have
3 been others.

4 Q. Faster timetable for going public?

5 A. Yes.

6 Q. They wanted that and Mr. Stemberg said no?

7 A. They wanted the company to grow much
8 faster and they thought the company's growth was
9 being restricted by too conservative a business
10 approach by Mr. Stemberg.

11 Q. And the distribution center they opposed?

12 A. That's correct.

13 Q. And the question about entering downtown
14 Manhattan with stores, that was another decision
15 that Mr. Adler opposed and Mr. Stemberg favored?

16 A. Yes, although the reverse there.

17 Q. The reverse, I'm sorry, right. Ultimately
18 Mr. Adler ended up without Mr. Samuels on the
19 board, right?

20 A. That's correct.

21 Q. Then we had Mr. Hardyman who got into an
22 argument over the price of the round B with Mr.
23 Stemberg, right?

24 A. Yes, among other arguments but that was
25 certainly a key one.

1 Q. And that occurred some time in the late
2 fall of 1986 or early 1987, right?

3 A. I don't recall. It was shortly later that
4 he was replaced by Mr. Burgin but I don't recall
5 when that occurred.

6 Q. And Mr. Burgin was from the same firm but
7 a different individual, right?

8 A. That's right.

9 Q. In fact, Mr. Hardyman was not actually a
10 board member, was he?

11 A. No, I believe he had information rights
12 and, therefore, attended the meetings. Although
13 I'm - I don't believe he was a member of the board
14 at that time.

15 Q. And after the dispute with Mr. Stemberg he
16 couldn't go back to the board meetings anymore,
17 right?

18 A. After that was resolved. There was an
19 extensive period of time when there was, what will
20 I call it, argument between the two parties and it
21 was ultimately resolved and Tom won and got Felda
22 Hardyman replaced.

23 Q. That occurred right after the round B
24 closed, right?

25 A. Yes, I believe so but I'm very fuzzy as to

1 the timing of those discussions.

2 Q. Well, the first meeting after the round B
3 closed was in February of 1987, do you recall
4 that?

5 A. I have noted that that's when round B
6 closed, yes. But whether Mr. Hardyman's dispute
7 was in and around round B or round C is not sharp
8 in my mind. But at the time, if we could find the
9 time when Mr. Burgin was let on the board I would
10 say that in the previous few months the argument
11 began.

12 Q. You know the argument with Hardyman was
13 over the price of the round B, right, and the
14 closing of the round B was in January of 1987?

15 A. I believe it was round B. I'm not sure
16 whether it was round B or C. I believe it was
17 round B and, therefore, the time would have been
18 in and around the beginning of 1987, yes.

19 THE COURT: Let me ask counsel,
20 it's all interesting to hear about these board
21 disputes. Where is this going?

22 MR. WALSH: I want to show the
23 strength of Mr. Stemberg on the board. We've
24 heard testimony that he was in trouble on the
25 board, that he was at risk of getting fired and

1 the reality seems to be every time he got into a
2 fight, there were only two really, and he won. So
3 that there was no real basis to believe that he
4 was ever in any trouble at the board.

5 Your Honor may recall as well there
6 was testimony from Mrs. Stenberg as to what Mr.
7 Stenberg had told her concerning his job prospects
8 and how shaky or not shaky he was with the
9 company.

10 THE COURT: You can have it. By
11 the way, didn't Adler, when Adler's representative
12 was removed from the board was he replaced by
13 someone from Adler & Company?

14 A. No, he was not.

15 THE COURT: Samuels, he wasn't?

16 A. He was not.

17 THE COURT: Didn't Adler &
18 Company's position entitle them to a board member?

19 A. Yes, it did.

20 THE COURT: How was that resolved?

21 A. I don't recall the agreement but --

22 THE COURT: They agreed to
23 relinquish their right?

24 A. They agreed to relinquish their right to
25 have that position.

1 THE COURT: Okay.

2 A. And I don't recall why.

3 Q. Now, sir, with regard to your definitions
4 here, when you did your report you had in mind a
5 definition of fair market value, right?

6 A. That's correct.

7 Q. And that was I believe a willing buyer and
8 a willing seller, neither being under any
9 compulsion, both having full knowledge of all
10 material facts?

11 A. I didn't define it quite that way but I
12 would have if I could have but that sounds fine.

13 Q. All right. And did you, with respect to
14 what was material, sir, did you understand that
15 term to mean as you used it in your definition the
16 information which would be of importance to
17 someone in making a decision?

18 A. Yes.

19 Q. And in defining the word material for me
20 in your deposition did you say that "If it's a
21 private company such as Staples and I had a great
22 deal of information and buyer had limited
23 information then the information I had which would
24 then significantly aid the buyer in valuing what
25 the current and future value of the shares might

1 be I would feel an obligation to let them know"?

2 A. Yes.

3 Q. And that's your definition of material as
4 you've used it here, sir?

5 A. I think what I said in that quote was
6 talking about my obligation to let someone know
7 something that was material which I defined as
8 something that would significantly affect the
9 value of the stock, yes.

10 Q. That's something that, in fact, you do do
11 in your own practice, right, when you're buying or
12 selling securities?

13 A. Certainly when we're selling securities we
14 have that obligation. When we're buying we hope
15 the other party exercises that obligation.

16 Q. That's a definition that you had in mind
17 when you were defining fair market value here,
18 isn't it?

19 A. Yes.

20 Q. It's true, is it not, that one of the
21 reasons for that is that, particularly in the kind
22 of investment that you're talking about here with
23 a start-up or a small starting out firm, a
24 nonpublic firm the future value is what's really
25 of importance to you?

1 A. The risk and the future value are the two
2 elements of greatest importance to me.

3 Q. And each relates to the other, right?

4 A. When you say "each relates to the other"
5 I'm not sure what you mean.

6 Q. Well, when you go to your partners and
7 make a recommendation, sir, about how to invest
8 the funds of your firm it's true, is it not, that
9 what you do is you project out the entity value to
10 some point in the future?

11 A. That's correct.

12 Q. And you do that based upon the use of a
13 series of multiples of sales or earnings or and/or
14 book?

15 A. Correct.

16 Q. And you get those from publications that
17 you subscribe to, you get those multiples from
18 there, right?

19 A. Yes. We actually rely upon our own
20 experience than looking at tables that are
21 available from the books. But we do use multiples
22 of that nature.

23 Q. Then you apply those multiples to
24 projected sales, projected earnings of the
25 company?

1 A. That's correct.

2 Q. And, indeed, what you are looking to do,
3 sir, is to get the future value of the company in
4 mind to determine the wisdom of a proposed
5 investment, right?

6 A. That's correct.

7 Q. In fact, that's always the starting point
8 according to you, is that right, the entity value
9 in the future?

10 A. Yes, that's one aspect of the initial
11 analysis.

12 Q. That's where you start from, isn't it,
13 sir? That's where you always start from, in fact?

14 A. The term start from sounds okay I guess.

15 Q. Then what you do is after you've got that
16 number in mind at a particular point in the future
17 you discount back to determine based upon the
18 price that you're being asked to pay whether or
19 not that's a fair price or at least whether or not
20 you hurdle rate or it doesn't?

21 A. That's exactly right.

22 Q. That's a particular method of a venture
23 capitalist, right?

24 A. That's one of the methods that a venture
25 capitalist would use and a typical method of

1 assessing the price of a security.

2 Q. And it's the typical one used at Bain,
3 isn't it?

4 A. Yes, it is. What you have ignored is the
5 risk element but --

6 Q. The risk element is, in fact, an element
7 of the discount rate, isn't it?

8 A. Yes and no. For instance, if the
9 calculation shows a very wonderful future value
10 but if I don't think that will ever occur, if I
11 think there's only 1 percent chance of getting
12 that value we won't make the investment at all
13 irrespective of a discount rate.

14 So we look at a future value, then
15 look at the probability of achieving that value
16 under various scenarios. If we think that
17 probability is high enough we'll look at the risks
18 and assign a discount rate to that particular
19 scenario.

20 Q. And in this particular case you
21 determined, did you not, that by September of 1987
22 you felt that there was at least someplace between
23 a 50 and a 75 percent chance that this company
24 would go public around the period of mid 1989?

25 A. No, would not.

1 Q. Did you assess a series of probabilities
2 in your deposition, sir?

3 A. Yes, I did.

4 Q. And one of them was that it went public
5 and did so at what you called a favorable price?

6 A. Yes. That was a 25 percent probability.

7 Q. And then there was the 25 percent
8 probability that it would go public but at a not
9 so favorable price?

10 A. Correct.

11 Q. Then there was a 25 percent probability
12 you'd have to get your money back through the
13 liquidation preference?

14 A. Correct.

15 Q. And then there was another probability
16 that sort of was somewhere in between the last
17 two, right?

18 A. Well, somewhere in between zero and
19 getting our money back.

20 Q. Okay. Ultimately, sir, having weighed all
21 of those probabilities as to the success of the
22 company in the fall of 1987 and based upon
23 everything you knew you made a projection, did you
24 not, that this company in your mind was likely to
25 succeed and become a public company?

1 A. No, the assessment I made was exactly as
2 you described before which is I believed there was
3 a 25 percent probability it would be a successful,
4 a highly successful investment. There was a 25
5 percent probability it would be an okay
6 investment, a 25 percent probability it would be a
7 bad investment but we'd get our money back and a
8 25 percent probability we'd lose money.

9 So I considered all four of those
10 outcomes and with that range concluded we should
11 invest at 2.90 a share.

12 Q. And concluded as well that a \$6 a share
13 IPO price was quite realistic in your view, right?

14 A. In my opinion there was a 25 percent
15 chance of it being 5 or \$6 or even more.

16 Q. And at \$6 IPO price you thought that that
17 was realistic, didn't you, sir?

18 A. A realistic number, yes. It's within the
19 realm of possibility given my probabilities.

20 Q. It was more of a probability, it was
21 realistic, wasn't it?

22 A. I assessed it at 25 percent.

23 Q. 25 percent. And assuming that that, that
24 you projected out that price, sir, you did that
25 for the period of mid 1989, didn't you?

1 A. I did that for 1989 or 1990 as best I can
2 recollect.

3 Q. You can't recollect exactly what period it
4 was for?

5 A. I do not recall the specific period I
6 would have selected but it would not have been
7 material to my calculation or decision to make an
8 investment in the company.

9 Q. Well, did you determine that in the round
10 C you were applying a 30 or 40 percent hurdle
11 rate, sir?

12 A. Yes.

13 Q. So if we started from the \$2-a-share price
14 using that hurdle rate it's true, is it not, that
15 we could figure out what the ultimate entity value
16 is?

17 MR. DWORK: I pray Your Honor's
18 judgment. Well there is such a thing as an
19 ultimate value but the real question what is the
20 value at a given rate at a given time.

21 Q. Let me strike it and make it easier. Sir,
22 do you remember what the future value number was
23 that you started with when you made your
24 calculation?

25 THE COURT: Talking about now the

1 fall of '87?

2 Q. Yes, in the fall of '87 when you made the
3 decision to invest in the C.

4 A. I don't recall the specific number that I
5 used at that time other than I do recall looking
6 at numbers in the range of 100 to \$130 million as
7 a value to be realized in the '89 or '90
8 timeframe.

9 Q. And that is a matter that you discussed
10 with Mr. Stemberg, right, those prices and those
11 timeframes?

12 A. I certainly must have discussed the future
13 values of the company in general terms, yes.
14 Although the specific numbers I didn't discuss
15 with him. My own assessment, his assessment was
16 north of mine as I recall on most of these
17 matters.

18 Q. And did Mr. Stemberg specifically give you
19 a memorandum which indicated, and this is in
20 August of 1987, a memorandum which indicated that
21 he believed a \$6-a-share price was realistic for
22 mid 1989?

23 A. I don't recall the specific memorandum but
24 I presume there was a memorandum prepared with
25 regards to the offering of the preferred C and I

1 would have received that.

2 Q. Did you receive the draft of the round C?

3 A. I presume I would have. I don't have it
4 in my fresh memory.

5 Q. Do you recall if there was a price set in
6 that?

7 A. I don't recall.

8 Q. Who wrote it, the draft of the round C, do
9 you know?

10 A. Management of the company including I'm
11 sure Mr. Stenberg. Primarily he would be the
12 author of such a document I presume. If you have
13 a copy of it I'll give you a better opinion.

14 Q. Let me show you Exhibit 14, sir.

15 THE COURT: While you're doing that
16 we'll take the afternoon recess.

17 (Recess)

18 THE COURT: Mr. Walsh.

19 MR. WALSH: Thank you, Your Honor.

20 Q. Sir, before we go to the document you have
21 in front of you it's true, is it not, that there
22 are occasions as in this particular, in the line
23 of business that Staples is in where such
24 companies go public before they turn a profit?

25 A. Yes.

1 Q. And, in fact, could you tell His Honor the
2 names of a couple of companies that are
3 competitors that did that?

4 A. I know one which was HQ which is an office
5 supply look-alike, Staples look-alike that went
6 public in, I don't exactly recall the timeframe
7 but probably 1988 or 1989 before they had opened
8 even one store. They went public, raised some
9 money, opened some stores and then went bankrupt.

10 Q. How about Office Depot, did they go public
11 before they had turned a profit?

12 A. I don't recall but they may have. I just
13 don't recall. They went public before Staples did
14 and my guess is that would mean they probably
15 hadn't turned a profit yet when they went public.

16 Q. Now, sir, if you could look at - what's
17 the exhibit number you have there?

18 A. Exhibit 14.

19 Q. Exhibit 14. Have you had a chance to look
20 that over during the recess?

21 A. I had the chance but I didn't take the
22 opportunity. But I did look briefly at the first
23 couple of pages.

24 Q. And is that a memorandum that you received
25 from Mr. Stemberg in August of 1987?

1 A. Yes.

2 Q. And that was a draft of the round C memo, '
3 right?

4 A. Excuse me, I don't know when I received
5 it. It's dated here October '87 so I don't know
6 when I received this but I did receive it
7 associated with the round C or the preferred C
8 financing.

9 Q. Well, if you'll notice, sir, it's
10 actually, it's got several different dates on it
11 in different places at the top, does it not?

12 A. Yes, it does.

13 Q. Having in mind, sir, that the round C was
14 approved on September 22nd is it fair to say that
15 you received this draft of the C some time before
16 that date?

17 A. No, that wouldn't tell me whether I had
18 received this before that date or whether this was
19 prepared after the date that the board authorized
20 seeking securities at 2.90. As a matter of fact,
21 this looks more to me like something that was
22 prepared after the board had approved the 2.90
23 price but again I don't have a record as to when I
24 saw specifically this document.

25 Q. Well, the actual round C memorandum, sir,

1 is dated September 17, 1987, is it not, if you can
2 look?

3 A. I don't know. If you'll refer me to
4 the --

5 THE COURT: In the means of saving
6 time is there any dispute about that?

7 MR. WALSH: I don't think so.

8 THE COURT: Assume it's so.

9 Q. On that assumption, sir, that the actual
10 round C memorandum is dated September 17, 1987, is
11 it fair to say that you received Exhibit 14 some
12 time before that date?

13 A. It's not. I just don't recall when this
14 was received but I did receive it and I can review
15 it.

16 Q. You had the round C memo in front of you
17 at the board meeting on September 22, didn't you?

18 A. I don't recall that but I, if it had been
19 prepared before the board meeting I would have had
20 it with me, yes.

21 Q. You have no recollection whether or not
22 the round C memo was actually at the meeting?

23 THE COURT: Talking about the memo
24 or the draft memo?

25 MR. WALSH: The memo itself, Your

1 Honor.

2 A. I don't actually have a memory of having
3 the memo with me at the board meeting.

4 MR. DWORK: Your Honor, with
5 respect to agreeing I can only say there is a
6 letter of September 17 to the holders of the Class
7 A. It has not been established as far as I know
8 and I have no personal knowledge as to whether
9 that was considered part of the offering or
10 whether it was sent before or whether, what the
11 significance of September 17 is in relation to the
12 actual offering as opposed to the letters which
13 are referred to and that's Exhibit 10, Your Honor.

14 MR. WALSH: Yes, I've just directed
15 the witness to Exhibit 10, Your Honor.

16 Q. Does that help you, sir, looking at
17 Exhibit 10?

18 A. It does help me but it doesn't tell me
19 whether I had this with me or I had received it
20 prior to the time of the board meeting. I presume
21 I would have received it but I don't recall
22 whether I had this prior to the board meeting or
23 not.

24 THE COURT: You can't assume or
25 presume. You can just talk from your best

1 memory. If you don't know you don't know.

2 A. I don't know whether I had this with me at
3 the board meeting.

4 Q. If you'll turn back to Exhibit 14, sir.
5 When you received - we did establish, did we not,
6 that you received Exhibit 14?

7 A. Yes.

8 Q. When you did receive it, sir, I take it
9 you read it?

10 A. Yes.

11 Q. And particularly directing your attention
12 on page 2, sir, to the first paragraph, did you
13 and Mr. Stemberg discuss the figures that he had
14 in there of a premoney valuation of \$135 million,
15 did you discuss that with Mr. Stemberg?

16 A. We have discussed, yes, that premoney
17 valuation.

18 Q. Had you discussed that with Mr. Stemberg
19 by the time of the board meeting in which you
20 approved the round C?

21 A. I believe so.

22 Q. And with regard to the, if we can look,
23 sir, at Exhibit 14 - I'm sorry, Exhibit 13.

24 MR. DWORK: Does Your Honor have
25 these exhibits?

1 THE COURT: I have access to them.

2 Q. Actually we should have them out before
3 The Court. If you'll look at Exhibit 13.

4 THE COURT: Are you going to be
5 focusing on any particular one?

6 MR. WALSH: On the document, yes.

7 THE COURT: Which ones are you
8 going to be looking at?

9 MR. WALSH: 13, 14, 15. You can
10 strike 15. It's just 13 and 14 and 136.

11 THE COURT: And 136?

12 MR. WALSH: Right.

13 Q. Now, the letter of August or September
14 1986, sir, we started to discuss earlier this
15 afternoon. That's Exhibit 13. Do you have that
16 in front of you?

17 A. Yes, I do.

18 Q. If you'll take a look, sir, to the, I
19 think it's titled "Valuation Page," is it?

20 A. Approximately four pages in.

21 Q. Yes. Do you have that in front of you?

22 A. Yes.

23 Q. That was a document you saw at your
24 deposition on July 17th, 1990, is it not?

25 A. Yes.

1 Q. And at that time, sir, did you testify
2 that in board meetings or discussions that Tom had
3 taken you through a methodology of how he thought
4 the company would be valued in the future?

5 A. Yes.

6 Q. And that in doing that he'd use multiples
7 of earnings and of revenues?

8 A. Multiples of earnings was the methodology
9 I recalled.

10 Q. And that he did so to come up with numbers
11 that he thought we might be able to go public at
12 and we discussed those, that is, you discussed
13 those with Mr. Stemberg, right?

14 A. That's correct.

15 Q. And that Mr. Stemberg had discussed with
16 you and the board in general as well as a wide
17 range of investors what he thought the company
18 could be worth and that was based on a series of
19 multiples?

20 A. That's correct.

21 Q. And that you did recall at your deposition
22 a document which you and Tom looked at that showed
23 various multiples?

24 A. That's correct.

25 Q. And you were shown what was marked in your

1 deposition, sir, it doesn't appear to be on this
2 particular copy but you were shown Exhibit 6 and
3 you recognize what is now Exhibit 13 in this trial
4 as Exhibit 6 that you saw in your deposition?

5 A. I recall seeing Exhibit 13 which I'm
6 looking at. I don't recall whether that's the
7 same as Exhibit 6 because I didn't memorize the
8 exhibit numbers of what I saw at my deposition.
9 But I did see this at my deposition.

10 THE COURT: Does it matter what
11 number it was marked at the deposition?

12 MR. WALSH: Only to make sure that
13 he understands that it is the same document, Your
14 Honor.

15 THE COURT: He says he saw it in
16 his deposition.

17 A. I saw this document in my deposition.

18 Q. Okay. And you said, did you not, that
19 that was, that the document that you recalled, in
20 fact, what is now Exhibit 13 was the multiple page
21 document you recalled reviewing with Mr. Stemberg?

22 A. Yes.

23 Q. And that you had discussed with Mr.
24 Stemberg the price range that was reflected on
25 there of ranging from \$80 million to \$170 million?

1 A. Yes.

2 Q. And that you and Mr. Stemberg in the
3 course of your discussion that the \$170 million
4 figure didn't enter into a lot of your discussions
5 as being the right number, nor did the 80 million,
6 that it was closer to the \$120 million kind of
7 range, 100 to 120?

8 A. 100 to 120, yes.

9 Q. And that, sir, was a document from
10 September of 1986, wasn't it?

11 A. Yes, that was when it was dated.

12 Q. And that document is something that you
13 discussed with Mr. Stemberg in late 1986 or early
14 1987, isn't it?

15 A. Whether I discussed this document or not
16 I'm not sure but we discussed these values and
17 these multiples of values, yes.

18 Q. At that time period?

19 A. That would have been around the, prior to
20 the series B financing and we would have discussed
21 valuations around that time period, yes.

22 Q. And valuations consistent with what's in
23 the document before you in Exhibit 13, right?

24 A. Yes.

25 Q. And when you had the discussions with Mr.

1 Stemberg in connection with the round B financing
2 is it fair to say that the IPO price that you were
3 looking for was around 100 to \$120 million?

4 A. We can see those before us as I can see
5 it. The answer is yes, we were looking for an IPO
6 value in the future of 100 to \$120 million would
7 be our objective.

8 Q. Now, you believed, did you not, that Mr.
9 Stemberg was a consummate salesman?

10 A. Yes.

11 Q. Based upon your experience with him in
12 business?

13 A. Yes.

14 Q. And that he was a very persuasive
15 individual?

16 A. Yes.

17 Q. And you believed that through 1986, did
18 you not?

19 A. Yes.

20 Q. And in 1987 as well?

21 A. Yes.

22 Q. And did you receive at some time a
23 document from counsel titled "Brontes' suggestion
24 for VC testimony"?

25 A. Yes.

1 Q. Did you receive that before you prepared
2 your opinion?

3 A. Yes.

4 Q. Now, with regard to the - by the way, did
5 you ever see a report to the management committee
6 of Goldman Sachs in February of 1989 shortly
7 before the company actually did go public?

8 A. I don't recall. I may have, I don't
9 recall. I don't believe so but it's possible.

10 Q. Did you report to Goldman Sachs in the
11 fall of 1987, specifically October of 1987 to Mr.
12 Kiernan at Goldman Sachs that you were highly
13 confident in management's ability to meet or
14 exceed its projections?

15 A. I don't recall.

16 Q. Do you know who Mr. Kiernan is?

17 A. We have defined him before as someone
18 being with Goldman Sachs but I don't believe I
19 told him that I was highly confident management -
20 would you repeat --

21 Q. How about confident that management would
22 meet or exceed its projections?

23 A. I don't recall. I'm sure Goldman Sachs
24 talked to me. I do recall speaking with Goldman
25 Sachs with my assessment of management and its

1 capabilities. And in my discussion with Goldman
2 Sachs I was complimentary of Tom and of his
3 ability to manage the company, yes.

4 Q. That was in the October 1987 time period,
5 wasn't it?

6 A. I don't recall the specific time I spoke
7 with them but it was prior to their working with
8 the company in what we called project grain belt a
9 moment ago.

10 Q. And if I can show you, sir, a document
11 dated November 12, 1987.

12 MR. DWORK: May I see what you're
13 looking at?

14 MR. WALSH: Yes, it's the Goldman
15 Sachs engagement.

16 A. Is this an exhibit?

17 Q. It is but that's not the right exhibit
18 number so pay no attention. Are you familiar with
19 that document, sir?

20 A. I don't believe I saw the document but I'm
21 familiar with its terms because they were
22 discussed by Mr. Stemberg with me.

23 Q. And who negotiated that agreement with
24 Goldman Sachs?

25 A. My belief is Tom Stemberg did.

1 Q. He did discuss it with you in your
2 capacity as a board member?

3 A. Yes, he did.

4 Q. And did he ask you whether or not you
5 thought that Goldman Sachs would be willing to
6 undertake this kind of an inquiry on behalf of
7 Staples?

8 A. I don't recall.

9 Q. It's fair to say, is it not that Goldman
10 Sachs certainly has a reputation for not taking
11 every deal that comes its way?

12 A. That's right.

13 Q. So Mr. Stemberg, did he tell you that he
14 had to satisfy Goldman Sachs that his particular
15 proposal or his deal was a realistic deal?

16 A. He didn't tell me that as far as I can
17 recollect. I understand that, as you indicate,
18 they don't do work on frivolous activities.

19 Q. Now, you described Mr. Stemberg as
20 somebody whose job it was to "paint the dream"?

21 A. Yes.

22 Q. Would you tell His Honor what the dream
23 was that Mr. Stemberg painted to the board?

24 A. Painted to the board?

25 Q. Yes.

1 A. As of what time?

2 Q. Around the time of the round B.

3 A. Mr. Stemberg is an entrepreneur who saw it
4 in the best interest of himself as a shareholder
5 and of the other common shareholders, meaning the
6 employees and founders, to convince us that the
7 company would be worth vast fortunes in the
8 future. And so he spoke about the future as if it
9 were here today and minimized the, you know, in
10 raising money from board members individually
11 minimized the, in his own mind, the risks and
12 maximized the probability of a high degree of
13 success.

14 So the dream was that we would be
15 public some day at a 6 or \$7 million price per
16 share with an overall company value.

17 Q. 6 or \$7?

18 A. Dollars per share and that the overall
19 company value would, therefore, be 100 to 130
20 million. Incidentally, the dream went on. We
21 would some day be a billion dollar company but
22 that was, when I say billion I mean billion
23 dollars in revenue company some time in the
24 distant future.

25 Q. And he said that you should look to the

1 future and not to the present value, right, future
2 value, not the present value?

3 A. I don't recall saying that but --

4 Q. Did you recall him saying that at the time
5 of your deposition, sir?

6 A. I don't recall the specific phrase look to
7 the future value, not the current value but that
8 is clearly how we value a business. We do not
9 value the particular investment by adding up the
10 assets and sales of the current business but
11 instead consider its future value as a way of
12 assessing our investment. And he understood that.

13 Q. In Volume I of your deposition were you
14 asked the following question at page 57:

15 "Question" --

16 MR. DWORK: May I have just a
17 moment. Page 57?

18 Q. 57, right.

19 "Question: What did Mr. Stemberg
20 tell you was the basis upon which he arrived at
21 the conclusion that \$2.10 a share was the right
22 number?

23 "Answer: To the best of my
24 recollection the basis of valuation was to attempt
25 to convince other investors that in the future the

1 business would be highly successful and would
2 attempt to convince the investors not to look at
3 the company's current performance but to look
4 instead at what the company could do if it
5 achieved its objectives in the future.

6 "Of course in making that point one
7 attempts to downplay the risk factors and
8 emphasize the favorable aspects of the business.
9 And as Tom and I and other board members discussed
10 the potential to paint a dream we believed and Tom
11 believed that he could attract investors at the
12 higher valuation."

13 A. I did say that and agree with it.

14 Q. In the August and September timeframe,
15 sir, did you review the company's projections for
16 sales through 1988 and 1989?

17 MR. DWORK: Can we have a year?

18 Q. I'm sorry, in August or September of 1987
19 did you review the projections for the year 1988,
20 1989?

21 A. Yes.

22 Q. And were you satisfied that those were
23 competently done?

24 A. I'm satisfied that the arithmetic was
25 competently done but I was not highly confident

1 that we would achieve the numbers that were shown
2 on the page.

3 Q. You were not?

4 A. No.

5 Q. Is that what you reported to your
6 investors?

7 A. Yes.

8 Q. And is that, in fact, when you voted to
9 approve the issuance of the Class C round you were
10 aware, were you not, that certain projections were
11 to accompany it?

12 A. That's correct.

13 Q. And you knew that the projections
14 projected sales for the company of about \$127
15 million at least on one case, the optimistic case
16 or the conservative case, I'm not sure which, by
17 the fiscal year that ended in April of 1989, do
18 you recall that?

19 A. I recall roughly that, yes.

20 Q. And were you satisfied that that was
21 accurate, sir?

22 A. That that --

23 MR. DWORK: I pray Your Honor's
24 judgment as to what was accurate.

25 Q. The projection, I'm sorry.

1 A. Well, the projection - the difficulty I
2 was having with the word accurate. I concluded
3 that \$127 million was an optimistic forecast.

4 Q. You thought that was optimistic?

5 A. It was labeled optimistic.

6 Q. What was the conservative forecast, do you
7 recall?

8 A. I don't recall the number.

9 Q. Was it within about \$10 million or so of
10 the same figure?

11 A. I don't recall.

12 Q. In any case, were you satisfied that that
13 was also a realistic figure?

14 A. That was a realistic figure, yes.

15 Q. You received information, did you not,
16 that in August of 1987 that Mr. Stemberg was
17 involved in a search for potential chief operating
18 officer, did you not?

19 A. I don't recall the time period but I do
20 recall that in the last half of 1987 we had
21 prevailed upon Mr. Stemberg to look for a new
22 operating officer and I --

23 Q. When you say prevailed upon him, it was he
24 who came to the board and sought to have somebody
25 appointed to that post, wasn't it?

1 A. No. The genesis of that idea was Mr.
2 Samuels, Mr. Kahn and myself as the executive
3 committee asking Tom to begin a search for a chief
4 operating officer which he resisted.

5 Q. He resisted it?

6 A. Yes.

7 THE COURT: When was this done?

8 A. We discussed that meeting as I recall
9 yesterday as to when that discussion and that
10 dispute arose. It was an executive committee
11 meeting where Mr. Stenberg had Mr. Krasnow, K R A
12 S N O W, and Mr. John Masua, M A S U A, present to
13 the executive committee and my recollection is
14 that it was following that meeting that we
15 requested that Tom Stenberg begin a search for a
16 chief operating officer.

17 THE COURT: Do you recall
18 approximately when that meeting occurred?

19 A. I had believed that that was some time in
20 earlier 1987 but I don't recall.

21 THE COURT: Early '87?

22 A. Yes.

23 Q. Sir, let me show you a memorandum dated
24 August 10, 1987 from Mr. Stenberg to the board.

25 MR. DWORK: Was there a number on

1 that?

2 MR. WALSH: No.

3 MR. LIEBERT: It's Exhibit 136 I
4 believe.

5 Q. 136, thank you. Now, do you recall
6 receiving that document, sir?

7 A. I don't recall receiving the document but
8 I recall this document.

9 Q. In fact, it's got your handwriting on it,
10 doesn't it?

11 A. Yes, it does.

12 Q. You produced it, didn't you?

13 A. I produced the handwriting. I didn't
14 produce the document.

15 Q. When I say "produced," did you turn that
16 document over to us at the time of your
17 deposition?

18 A. I don't know but I presume so. I guess
19 I'm not supposed to presume. I don't recall
20 whether I turned this document over to you,
21 although it has my handwriting on it so that must
22 be how you got it.

23 Q. That memo, sir, dealt with the subject,
24 among other subjects, of chief operating officer,
25 when and who, right?

1 A. Correct.

2 Q. And in it Mr. Stenberg described his
3 duties and whether or not a chief operating
4 officer was needed, right?

5 A. Correct.

6 Q. And in the memo in short, sir, he
7 concluded, did he not, that a chief operating
8 officer was a good idea?

9 A. That's correct.

10 Q. And, in fact, he recommended it to the
11 board, didn't he?

12 A. Yes, he did.

13 Q. For a number of reasons?

14 A. That's correct.

15 Q. One of the reasons was that he had some
16 several time-intensive CEO roles then going on,
17 right, as he set it forth?

18 A. If you mean by that he had many duties
19 that outstripped his ability to perform them all
20 the answer is yes.

21 Q. And he outlined them in the memo, didn't
22 he, for about a page and a half?

23 A. Yes, he outlines his duties.

24 Q. And he explained that with all of his
25 activities and deals and raising bank financing

1 and the prospect of an IPO he needed a chief
2 operating officer?

3 A. That's correct.

4 Q. And in the course of that discussion, sir,
5 he noted that, "Assuming we are over four to six
6 months away from an IPO (and mid 1989 is 24 months
7 off) and that I am not involved in a 'deal' I,
8 nevertheless, play several time-intensive CEO
9 roles," right?

10 A. Correct.

11 Q. And then went on to list them?

12 A. Yes.

13 Q. Early in the memo he described a couple of
14 deals that he had been involved in, didn't he?

15 A. Yes.

16 Q. And he also described the \$8 million
17 equity financing, right, that had just closed?

18 A. Yes, he does.

19 Q. In fact, sir, when you testified yesterday
20 you indicated that the distribution center was an
21 issue that came up in August or September, in the
22 late fall or in the fall I should say of 1987,
23 right?

24 A. I don't recall the time.

25 Q. Is it fair to say that by August or

1 September of 1987 the Connecticut distribution
2 center was, indeed, already under construction?

3 A. I don't recall the date, I'm sorry.

4 Q. And do you remember approving the Putnam
5 distribution center in April of 1987?

6 A. I recall approving the Putnam distribution
7 center but I could not tell you the time that that
8 was done. It was done at a board meeting.

9 Q. Did you discuss with Mr. Stemberg - well,
10 did you have any conversation with Mr. Stemberg in
11 response to receipt of this particular memo?

12 A. I don't recall whether I discussed this
13 particular memo but we did have extensive
14 discussions about hiring a chief operating officer
15 for the company.

16 THE COURT: Well, do I understand
17 your testimony that you prevailed upon Mr.
18 Stemberg to hire a COO and after you prevailed he
19 then circulated that memo to the board suggesting
20 that a COO be hired?

21 A. Yes. My testimony is that the chronology,
22 and while I can't specify dates, was that he, it
23 was the suggestion of the executive committee that
24 John Masua was not strong enough to be the
25 operating officer that the company needed, that we

1 needed to find a chief operating officer of the
2 company. Tom resisted that. He had confidence in
3 Mr. Masua and we were at conflict over that issue
4 for a period of several months.

5 He then concluded that we were
6 right and he was wrong and embraced the idea of
7 finding a chief operating officer and began a
8 process of finding one.

9 THE COURT: So in terms of the
10 chronology that memo that you were shown as
11 Exhibit 136 came after your discussions with him
12 which you initiated concerning hiring this COO?

13 A. Yes, this memo was at a time when he
14 concurred with us that we should find such an
15 executive and that was, and his concurrence was
16 after we had discussed this at odds.

17 Q. And it's not your recollection that it
18 was, indeed, this memo that triggered the search
19 for the COO?

20 A. It was that memo that triggered the search
21 for the COO.

22 Q. And that that search was the result of Mr.
23 Stenberg's request for one?

24 A. The search was as a result of his request
25 for one which in turn was a result of our request

1 that he do so.

2 Q. Is there any reference in here, in this
3 memo to your request, that is the board's
4 request --

5 MR. DWORK: I pray Your Honor's
6 judgment.

7 Q. -- that you find a COO?

8 MR. DWORK: Objection, Your Honor.
9 The witness testified that the executive committee
10 asked for a COO and this is a report to the board
11 of directors. So it's an entirely different
12 thing.

13 MR. WALSH: I'll rephrase this,
14 Your Honor.

15 THE COURT: It speaks for itself
16 anyway. Has it been put into evidence?

17 MR. WALSH: I believe it has, Your
18 Honor, as 136.

19 THE COURT: In the interest of
20 saving time if you can find out a statement that
21 says it rather than having --

22 MR. WALSH: In fact, I think he
23 would establish that it doesn't say it.

24 THE COURT: It speaks for itself.
25 It says what it says, it doesn't say what it

1 doesn't say. We'll suspend for the day.

2 (Whereupon, the hearing was

3 suspended at 4:10 p.m.)

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CERTIFICATE

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Commonwealth of Massachusetts

Norfolk ss.

I, Virginia L. Simmer, a Notary Public, do hereby certify that the foregoing record, pages 2893 through 3083, inclusive, is a complete, accurate and true transcription of my stenographic notes taken in the aforementioned matter to the best of my skills and ability.



VIRGINIA L. SIMMER

Mitt Romney
Part III

VOL. XXXII

PAGES 4686-4850

EXHIBITS

COMMONWEALTH OF MASSACHUSETTS

Norfolk, ss.

PROBATE AND
FAMILY COURT
DEPARTMENT

THOMAS G. STEMBERG,)
Plaintiff,)

v.)

MAUREEN SULLIVAN-STEMBERG,)
Defendant.)

No. 87D-802-D1

MAUREEN SULLIVAN-STEMBERG,)
Plaintiff,)

v.)

THOMAS G. STEMBERG,)
Defendant.)

Norfolk Complaint
in Equity for
Rescission of
Agreement
No. 90E0056

BEFORE: David H. Kopelman, J.

Dedham Probate & Family Court
Dedham, Massachusetts
Monday, October 7, 1991
10:40 a.m.

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APPEARANCES:

White, Inker, Aronson (W. Scott Liebert, Esq. and Joseph H. Walsh, Esq.), One Washington Mall, Boston, Massachusetts 02108, for Maureen Sullivan-Stemberg;

Barron & Stadfeld (Bernard A. Dwork, Esq. and Enid M. Starr, Esq.), Two Center Plaza, Boston, Massachusetts 02108, for Thomas Stemberg.

I N D E X

WITNESS

Willard Mitt Romney

Thomas G. Stemberg

DIRECT CROSS

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| | 4687 |
| 4708 | 4728 |
| 4757 | 4759 |
| 4769 | |

7/51

PENGAD CO., BAYONNE, NJ 07002 - LASER BOND-A

1 THE COURT: For the record this is
2 the case of Maureen Stemberg versus Thomas Stemberg,
3 docket numbers 90E0056 and 87D-802-D1.

4 In attendance today are Attorneys Joseph
5 Walsh and Scott Liebert representing Mrs. Stemberg
6 and Attorneys Bernard Dwork and Enid Starr
7 representing Mr. Stemberg.

8 This is the 32nd day of an evidentiary
9 hearing with respect to plaintiff's complaint in
10 equity to rescind the separation agreement and Rule
11 60B motion.

12 This will be the resumed
13 cross-examination of Willard Mitt Romney. For the
14 record this witness has been previously sworn.

15 I remind you you're still under oath, Mr.
16 Romney. All right, Mr. Walsh.

17 MR. WALSH: Thank you, Your Honor.

18
19 WILLARD MITT ROMNEY, Previously Sworn

20 CROSS EXAMINATION

21
22 CONTINUED EXAMINATION BY MR. WALSH:

23 Q. Good morning, Mr. Romney.

24 A. Mr. Walsh.

25 Q. Mr. Romney, there's something that I'd like

1 to -- some loose ends that I'd like to take care of
2 on your cross-examination.

3 You recall that when you did a chart --
4 Unfortunately, I don't see it here at the moment,
5 but you outlined the various restrictions on the
6 stock for comparative purposes* comparing C to
7 regular common and to Tom's common and the D?

8 A. That's correct.

9 Q. You recall those restrictions. And you had
10 a series of discounts that you took which applied to
11 common generally. That is, common that was not
12 subject to Mr. Stemberg's restrictions. Do you
13 recall?

14 A. Yes.

15 Q. And then I believe actually on your chart
16 you may have drawn a line at that point and then
17 continued on for those issues that related just to
18 Mr. Stemberg's stock.

19 A. Yes.

20 Q. And specifically those were what we've come
21 to call the transfer restrictions and the forfeiture
22 restrictions?

23 A. Yes.

24 Q. And I'd like to talk to you about that if I
25 can. With regard to the transfer restrictions,

1 first of all, sir, I believe you indicated that you
2 felt that that was due a 10 percent approximately
3 discount for the transfer restrictions of the type
4 that Mr. Stemberg was subject to. Do you recall
5 that?

6 A. Yes. That's the approximate percentage.

7 Q. And I think you indicated in your
8 deposition, did you not, that you felt that the
9 transfer restrictions in this case were relatively
10 small in your experience or I should say the
11 discount for the transfer restriction was relatively
12 small in the case of Mr. Stemberg's stock as
13 compared to other classes that you've seen, is that
14 fair to say?

15 A. You mean the discount that I was applying
16 to it?

17 Q. Yes.

18 A. It's fair to say I was being conservative
19 in the amount of discount I was applying for Mr.
20 Stemberg's transfer provision.

21 Q. And if I recall your exact testimony, sir,
22 I think you said that you felt that Mr. Stemberg's
23 restrictions were limited in terms of time?

24 A. Yes.

25 Q. And that in your belief Mr. Stemberg would

1 not want to transfer the stock anyway. You recall
2 that?

3 A. I don't recall that, but that's possible.

4 Q. Well, is it possible or is it what you said
5 under oath in your deposition, sir?

6 A. Well, if you have a copy of my deposition
7 we can look at it and see.

8 Q. What's your recollection?

9 A. I do not recall what I said during my
10 deposition.

11 Q. All right. Did you say that --

12 MR. DWORK: Do you have a page?

13 MR. WALSH: Yes.

14 MS. STARR: Which volume, Mr. Walsh?

15 MR. WALSH: That's what we're going
16 to look for now.

17 Q. While we're looking for that, sir, it's
18 fair to say, is it not, that with regard to any
19 restrictions, whether they be transfer restrictions
20 or forfeiture restrictions, that in the event the
21 particular events which trigger those restrictions
22 are unlikely to occur, that there is little, if any,
23 discount for those types of restrictions?

24 A. I'm not quite sure I understand your
25 question.

1 Q. In the event, sir, that you conclude that
2 there's little probability that an event which would
3 be covered by a transfer restriction or a forfeiture
4 restriction is likely to occur, in that case then
5 there should be little, if any, penalty for the
6 existence of the restriction, is that fair to say?
7 Just yes or no.

8 A. If you --

9 Q. If you can --

10 MR. DWORK: I pray Your Honor's
11 judgment.

12 THE COURT: If you can answer it yes
13 or no. If you can't, you can answer it any way you
14 can.

15 A. Okay. Let me be very clear. If there were
16 an event which was very unlikely to occur, then the
17 discount for that event occurring would be small,
18 correct.

19 Q. Fine. And in September 1987, sir, were you
20 highly confident that Mr. Stemberg would stay with
21 the company?

22 A. No.

23 Q. You were not?

24 A. No. If you mean by that would stay meaning
25 neither fired nor quit. If you mean quit, you mean

1 when you say would stay, would you --

2 Q. Would stay with the company.

3 A. In other words, firing would be not
4 staying.

5 Q. Well, it's fair to say, is it not, that if
6 he got fired or if he quit --

7 A. He would not be staying.

8 Q. -- he would not be staying.

9 A. Okay. I'll say the same answer then. I
10 was not highly confident that he would be staying
11 with the company.

12 Q. Sir, did you testify on day 2 of your
13 deposition, page 71, "Question: And so you would
14 assess approximately a 10 percent discount to the
15 fact that Mr. Stemberg could not transfer his shares
16 except under certain circumstances on the assumption
17 that the probabilities were that if Mr. Stemberg
18 stayed with the company, it was unlikely that he
19 would want to transfer those shares?"

20 "Answer: That's right. I was highly
21 confident. If Mr. Stemberg were going to be leaving
22 the company, I would have assessed a higher penalty
23 to the transfer restrictions. But given
24 probabilities that suggested that at least near term
25 and potentially longer term he would be staying with

1 the company, that I've held this to a 10 percent
2 reduction in value."

3 A. Yes.

4 Q. Is that your testimony on July 17, 1980,
5 sir, under oath?

6 A. Yes, it is, and my answer referred to the
7 high confidence --

8 Q. No, sir, please. No question before you.

9 A. That is my testimony, and both answers are
10 correct.

11 Q. And the testimony you gave in the
12 deposition was truthful testimony, was it not?

13 A. Absolutely.

14 Q. Did you also describe Mr. Stenberg as a key
15 man to Staples?

16 A. Yes.

17 Q. And he was -- And what did you mean by a
18 key man, sir?

19 A. He was the chief executive officer.

20 Q. And was it your belief that he was a key
21 man to the success of the company?

22 A. Yes.

23 Q. And so in the event Mr. Stenberg was to
24 stay with the company, it was your belief, was it
25 not, that he would be unlikely to want to transfer

1 his stock?

2 A. That's correct.

3 Q. And similarly, in the event that he were to
4 stay with the company, you would agree, would you
5 not, that that would indicate that he would neither
6 be discharged nor fired as you've indicated before
7 or quit?

8 A. If the definition of stay is those things.

9 Q. Yes.

10 A. Yes.

11 Q. So then if we take a look, sir, at the
12 events of forfeiture, if I recall they're
13 essentially if we can break them into four
14 convenient categories. One was he would quit,
15 right?

16 A. Right.

17 Q. One was that he would be fired with cause?

18 A. Aha.

19 Q. One was he'd be fired without cause?

20 A. Aha.

21 Q. And one was that he would quit -- compete.

22 I'm sorry.

23 A. Correct.

24 Q. And in each of those instances, sir, with
25 the exception perhaps of firing without cause, those

1 events would require a voluntary act by Mr.
2 Stemberg, wouldn't they, at least three of the four
3 of them would?

4 A. Well, let's be specific. The firing would
5 not require a voluntary event.

6 Q. Well, it would require -- Forget the one
7 about firing without cause, and let's deal with
8 firing for cause. In order for Mr. Stemberg to be
9 fired for cause, he would have had to commit an act
10 which was forbidden under his employment agreement
11 and/or the directives of the Board, right?

12 A. That's correct.

13 Q. And with regard to quitting, that's
14 obviously a voluntary act on his part, right?

15 A. Certainly.

16 Q. And certainly his decision to compete, that
17 would be something that was voluntary on his part,
18 would it not?

19 A. Certainly.

20 Q. And so assuming, sir, that your deposition
21 testimony that I read to you just a moment ago was
22 true, it was unlikely given the probabilities that
23 according to your estimate that Mr. Stemberg was
24 going to commit any of those acts, isn't that so?

25 A. No, that's not so.

1 Q. Not so?

2 A. That's not so.

3 Q. Despite what you said under oath in your
4 deposition?

5 A. In particular because of what I said in my
6 deposition. What I said in my deposition is
7 consistent with that.

8 Q. No, no. There's no question before you,
9 Mr. Romney. One of the problems with being lawyers
10 we've all found, lawyers as witnesses tend to
11 ramble.

12 With regard to the prospects for this
13 particular company in September of 1987, sir, you
14 recommended that your firm invest in the round C,
15 did you not?

16 A. That's correct.

17 Q. And at the time that you made that
18 recommendation it was your belief, was it not, that
19 there was a reasonable probability that the company
20 would succeed?

21 A. Yes.

22 Q. And that the company had reasonably good
23 prospects?

24 A. Yes.

25 Q. And you thought that a 1989 IPO price of

1 about \$6 a share was realistic.

2 MR. DWORK: Well, I pray Your Honor's
3 judgment. He's assuming that Mr. Romney felt that
4 there was going to be an IPO in 1989 by that
5 question, and that hasn't been established.

6 MR. WALSH: I'm not assuming that,
7 Your Honor. I'm asking if that was his belief.

8 MR. DWORK: That wasn't the way he
9 expressed it.

10 THE COURT: But you're asking him two
11 things. You're asking him, A, whether there would
12 be an IPO; B, whether if there were an IPO it would
13 go out at \$6 a share. Why don't you break it down.
14 Your question assumes another question.

15 MR. WALSH: All right.

16 THE COURT: I don't have a problem
17 with your asking the question. My suggestion is you
18 break it down into two questions.

19 MR. WALSH: All right. Thank you,
20 Your Honor.

21 Q. Did you believe, sir, that a \$6 a share IPO
22 price was realistic in September of 1987? Let me
23 strike that because the timing is backwards.

24 In September of 1987, sir, was it your
25 belief that a \$6 a share IPO price was realistic?

1 MR. DWORK: I pray Your Honor's
2 judgment. That depends upon when the IPO was going
3 out. The first issue is did he believe there would
4 be an IPO; and if so, when.

5 THE COURT: I'll sustain the
6 objection. I'll let you rephrase.

7 Q. Sir, on page 91, volume 2. "Let me square
8 this away. You made these calculations I take it in
9 connection with making a determination as to what to
10 recommend to the other partners at Bain regarding
11 whether or not they should invest at \$2.90 a share,
12 right?"

13 "Answer: That's right. My calculations
14 suggested that the company could go public if we
15 achieved our plans in the \$6 a share range, and that
16 it could be better than that or worse than that. I
17 thought there was a realistic possibility that we
18 could go public at \$6 a share, and we could more
19 than double our money over a one to three-year time
20 frame."

21 A. Totally concur.

22 Q. Okay. And did you also believe, sir, that
23 the -- Strike that.

24 I think you told us that Mr. Stemberg --

25 MR. DWORK: Can I have a moment. You

1 said that was page 91. I don't see it.

2 MR. WALSH: 91 and 92. It carries
3 over.

4 MR. DWORK: I'm sorry.

5 Q. That Mr. Stemberg was very adept at
6 painting the dream?

7 A. Yes.

8 Q. And the dream was that the company would
9 become a public company, right?

10 A. Yes.

11 Q. And would do so at approximately a value of
12 around \$130 million?

13 A. There were a range of values that he spoke
14 about, but that was certainly one of those.

15 Q. And that was a dream that he painted, was
16 it not?

17 A. That's correct.

18 Q. And did you believe there was a reasonable
19 probability that dream would be achieved?

20 A. Yes.

21 Q. And you believed that in September of 1987?

22 A. Yes.

23 Q. And Mr. Stemberg had told you that that was
24 realistic, had he not?

25 A. That it was a realistic probability, yes.

1 Q. And you believed that Mr. Stemberg was
2 doing a good job at that time, did you not?

3 A. In some ways he was doing a good job. In
4 some ways he was not. So I can't answer that yes or
5 no.

6 Q. Did you testify in your deposition, sir,
7 that you believed that he was doing a good job?

8 A. I don't recall what I testified in my
9 deposition on that matter.

10 Q. Did you read your deposition before you
11 came here today, sir?

12 A. No, I did not.

13 Q. Page 154, 155. "We have been talking about
14 a good news/bad news scenario, sir." And then I
15 asked you concerning good news, and you said "The
16 good news was other people also thought this was an
17 area that had promise. This market is what we were
18 discussing. What other things would encourage me
19 thinking it was a good shot? Well, Tom was doing a
20 good job as the company's chief executive in a
21 number of respects. He was strategic in his
22 thinking. He was capable financially." Was that
23 true?

24 A. That's true.

25 MR. DWORK: I think the whole answer

1 should be read, Your Honor.

2 MR. WALSH: I'm asking if that part
3 is true.

4 THE COURT: Well, you can conduct it
5 the way you're doing it.

6 MR. WALSH: Thank you.

7 THE COURT: I'll let you read the
8 rest of it in, Mr. Dwork, if there's anything else
9 you want to add.

10 A. The answer to that question that Tom was
11 doing a good job in a number of respects is
12 accurate.

13 Q. And did you also say that by September of
14 1987 the evidence to you suggested that the concept,
15 the Staples idea, worked?

16 A. Yes.

17 MR. DWORK: I have no objection to
18 that question, Your Honor, but I would like him to
19 complete the answer which the witness gave on that
20 question that was read by my brother.

21 THE COURT: Just to save time why
22 don't you read the whole thing in. What page is it
23 on?

24 MR. DWORK: Page 155, Your Honor.

25 MR. WALSH: The answer continues.

1 "He had a number of weaknesses which were apparent
2 to us; but again, taken on the positive side he
3 looked to be a sound and capable manager. I'm
4 trying to recall when Henry Nasella came on board.
5 Do you know when?"

6 That was the rest of the answer.

7 Q. Now, sir, part of Mr. Stemberg's job as you
8 saw it was to try to convince people that the
9 company would be successful, right?

10 A. That's correct.

11 Q. And he did that, did he not? He did
12 attempt to convince people the company would be
13 successful?

14 A. Yes.

15 Q. And in the course of that, that was part of
16 when he was painting the dream about the public
17 company and what it could do in the future, right?

18 A. Yes.

19 Q. And in trying to convince people that the
20 company would be successful in the future, he in
21 fact emphasized the future, did he not, as opposed
22 to the present?

23 A. Yes.

24 Q. And he told people that they should look to
25 the future for the prospects of this company, did he

1 not?

2 A. Certainly.

3 Q. And in the course of trying to convince
4 people of the company's success in the future, he
5 attempted to minimize the risks?

6 A. Certainly.

7 Q. Do you recall, sir, in your testimony the
8 last time we got into a discussion about a minimum
9 price for the Board to go ahead with the transaction
10 involving Sears? There was some discussion about a
11 figure between \$100 and \$130 million I believe?

12 A. Yes.

13 Q. And do you recall the same subject was
14 discussed in your deposition?

15 A. Yes, it was discussed in my deposition as I
16 recall.

17 Q. And in the course of the deposition, sir,
18 you were asked in substance, were you not, what was
19 the price at which the Board was willing to sell?

20 A. I don't recall.

21 MR. DWORK: Do you have a page?

22 MR. WALSH: Yes. That was the
23 introductory to it, and it appears in volume 1, page
24 100.

25 MR. DWORK: May I have just a moment

1 please.

2 MR. WALSH: Beginning at page 100.

3 MR. DWORK: May I have just a moment
4 please.

5 MR. WALSH: Sure.

6 Q. Prior to reaching that question, sir, we
7 had had some discussion about this subject, and you
8 had used the term "the right price." Do you recall
9 that? That was your term?

10 A. I don't recall that, no, but I accept that.

11 Q. And then you were asked what was the right
12 price by me?

13 A. Okay.

14 Q. And you said "I don't recall what the right
15 price was. It was surely a different price for
16 different people. And what Tom would be willing to
17 accept and what I would be willing to accept and
18 other investors would be very different numbers. I
19 don't recall a specific discussion as to what the
20 right price would be with Goldman Sachs, but somehow
21 I had in the back of my mind a sense that if Goldman
22 Sachs were able to get \$100 million, that there
23 could be some interest among the investors. And
24 that if it were less than \$100 million, it probably
25 wouldn't be able to get a majority of people to go

1 along with it."

2 A. Correct.

3 Q. That testimony was accurate, was it not,
4 sir?

5 A. Yes.

6 MR. DWORK: Well, I think the rest of
7 the answer again ought to be read, Your Honor.
8 Would you read the rest of the answer please?

9 THE COURT: In the interest of saving
10 time rather than having Mr. Dwork read it in on
11 redirect, why don't you read it in.

12 MR. WALSH: I don't think the rest of
13 it is responsive to that issue, Your Honor.

14 MR. DWORK: I think it is, Your
15 Honor.

16 THE COURT: Well, read it in, and
17 I'll rule on a motion to strike.

18 Q. The answer continues "I may have in this
19 box somewhere something to describe that." You were
20 referring to a box you had at the deposition, right?

21 A. Yes.

22 Q. "There was an engagement letter as I recall
23 with Goldman Sachs, and as I recall some sort of a
24 break point of \$100 million being the point where
25 they would get a higher commission. And it may be

1 that document which is making me remember the
2 \$100 million. And I am frankly not able to
3 recollect the number the various people thought
4 might be the right kind of numbers we would settle
5 for."

6 A. That's correct.

7 Q. But what you did recall was that there was
8 not sufficient support among the majority of them at
9 less than \$100 million, right?

10 MR. DWORK: I pray Your Honor's
11 judgment. He testified on the deposition that the
12 figure of \$100 million was in his mind, but he
13 didn't know if that was based upon conversations
14 with investors or because that's what Goldman Sachs'
15 figure is on that document.

16 THE COURT: Well, he said that, but
17 he also said it was his view that less than
18 \$100 million would not generate interest among the
19 majority of investors. He may have it.

20 MR. WALSH: Thank you.

21 Q. Sir, did you tell me in your deposition
22 that -- Let me strike that for a moment.

23 With regard to that fee agreement and
24 engagement letter with Goldman Sachs, it was Mr.
25 Stemberg that negotiated that on behalf of Staples,

1 was it not?

2 A. To the best of my recollection, yes.

3 Q. And did you tell me in your deposition that
4 the person who negotiated that contract had
5 convinced Goldman Sachs that there was -- that they
6 had a reasonable chance of being able to get
7 \$100 million for the company?

8 A. Would you repeat the question?

9 Q. Yes. Did you tell me in your deposition
10 that the person who negotiated this contract with
11 Goldman Sachs on behalf of Staples had convinced
12 Goldman Sachs that they had a reasonable probability
13 of being able to get \$100 million for Staples?

14 A. I believe I testified that I presumed that
15 they had convinced Goldman of that but didn't know
16 that.

17 Q. That's a presumption based upon your
18 experience as a venture capitalist and experience in
19 dealing with Goldman Sachs in particular, isn't it?

20 A. Dealing with investment banks generally.

21 Q. Sure. And the future value that Mr.
22 Stenberg was discussing when he was painting the
23 dream at the time of the class B round in all of '86
24 or so and at the time of the class C round in about
25 the fall of 1987, the future value that he was

1 talking about in both instances remained the same,
2 did it not?

3 A. I believe so, yes.

4 MR. WALSH: I have nothing further,
5 Your Honor. Thank you.

6 THE COURT: All right. Redirect.

7 MR. DWORK: Yes, Your Honor.

8

9 REDIRECT EXAMINATION

10

11 EXAMINATION BY MR. DWORK:

12 Q. You were asked just this morning about the
13 four possibilities that would result in the
14 forfeiture of Mr. Stemberg's stock. One was that he
15 quit. One that he be fired with cause. One fired
16 without cause. And one that he might compete.

17 There was no mention of the possibility
18 that he might also die. Is it fair to say that when
19 you were presented with restrictions on his stock
20 that there was nothing on that document which
21 indicated that he would also have to forfeit his
22 stock if he died?

23 A. That's correct.

24 Q. And have you since found out that that in
25 fact is the truth?

1 A. I understand that there would have been a
2 forfeiture provision associated with his death.

3 Q. During your absence from court did I send
4 over to you part of the transcript of or a summary
5 of the transcript of Mr. Beach's comments upon your
6 mathematical computations as to probabilities?

7 A. Yes, you did.

8 Q. And first thing, let me ask you, sir, from
9 time to time here you have testified that something
10 was possibly going to happen or something was a
11 possible likelihood and that you've also talked
12 about probabilities. Differentiate between the
13 words possible and probable.

14 MR. WALSH: Objection. Leading.

15 MR. DWORK: I don't think it's
16 leading at all. I didn't suggest an answer, Your
17 Honor.

18 THE COURT: No. You can have it.

19 A. I suggest a significant difference between
20 possible and probable.

21 Q. How do you distinguish them?

22 A. I'm using layman's terms. The term
23 possible it seems to me is true any time there's a
24 .0001 percent chance of something occurring. The
25 word probable unmodified would mean in my opinion

1 above 50 percent chance. And the term reasonably
2 probable would be something 20 percent or better.
3 I'm again using layman's terms. Probable meaning
4 more likely than not likely. Possible meaning in
5 the realm of great possibility.

6 Q. Fine. So when you said that there was a
7 reasonable probability of success as you looked
8 forward from September of 1987, can you equate that
9 a little better for us as to what you really meant?

10 A. I believe in my deposition I had assessed
11 at different times the probability that the company
12 would achieve the dream, and as I recall from my
13 deposition I indicated that there was approximately
14 a 25 percent chance in my looking in fall of 1987
15 that the company would achieve the dream that Tom
16 had suggested, that there was approximately a 50
17 percent chance it would achieve about half of that
18 amount plus or minus something, and about a 25
19 percent chance we'd lose everything.

20 Q. And sir, while you're talking about that,
21 sir, did that prospective reasonable probability as
22 you put it, did that affect your decision to
23 recommend the price of \$2.90 a share to your
24 investors in September 1987?

25 A. Certainly. If I were highly confident that

1 the company would achieve the dream and, therefore,
2 it would be worth \$6 a share. If I thought, for
3 instance, there was a certainty it would become
4 public at \$6 a share, I probably would have been
5 willing to pay \$5.85 a share for the stock. If on
6 the other hand I thought there was almost no chance
7 of it being worth \$6 a share, only a 1 percent
8 possibility of it being worth \$6 a share, I probably
9 would have only paid a few pennies a share. But I
10 assessed the probability of the \$6 outcome versus
11 probabilities of failure or partial failure to
12 assess the value of \$2.90 a share.

13 Q. Now you, of course, read somewhere along
14 the line before you -- Let me put it differently.

15 Did you before actually putting down
16 \$2.90 a share in I believe December of 1987, did you
17 read that C memorandum?

18 A. Yes.

19 Q. And you do recall that it said that it was
20 their intention to go public in mid 1989 when the
21 company turned profitable?

22 A. I do not recall whether in the C memorandum
23 there was a specific projection as to timing. I did
24 read the C memorandum at the time it was provided
25 and had discussions with Mr. Stemberg as to the

1 value of the company if it went public.

2 Q. Let me see if I can refresh your memory on
3 that.

4 MR. WALSH: Exhibit 10, Bernie, about
5 four pages in.

6 MR. DWORK: Thank you.

7 Q. Let me leave that and go back to it. Going
8 back again to Mr. Beach's criticisms of your
9 mathematical computations on the value of Tom's
10 stock, do you still adhere to your original
11 computations?

12 A. Absolutely.

13 Q. And does that mean that you disagree with
14 either Mr. Beach's approach or with his
15 understanding of what your approach was?

16 A. I do not disagree with Mr. Beach's
17 approach. I, however, find that he misunderstood
18 the probabilities I was assessing for various
19 outcomes and, therefore, reached an inaccurate
20 mathematical conclusion as to my outcomes.

21 Q. And what is it you were saying that you
22 believe he didn't grasp?

23 A. I was looking at each of the events of
24 forfeiture as an independent likelihood, and I could
25 if you would like put the chart up on the board and

1 show the different percentages which yield the
2 conclusion which I reached and why I had reached
3 that conclusion.

4 What I was doing in assessing the likely
5 event of forfeiture was looking at each event as an
6 independent probability, and then multiplied those
7 events out in the same way Mr. Beach did although
8 the percentages I was applying were different than
9 those he applied, and my percentages were based upon
10 my judgment of the likelihood of those events.

11 Q. So each were independent possible events as
12 opposed to being dependent upon a prior event
13 occurring?

14 A. That's correct. Specifically, the most
15 notable is this which is in the calculations which
16 Mr. Beach carried out, he for instance would show
17 Mr. Stenberg being fired and then would have as a
18 subsequent event did Mr. Stenberg decide to compete
19 or not, and he used my probability of competition of
20 5 percent to say if Mr. Stenberg were fired there
21 would be only a 5 percent chance he would compete.
22 That is inaccurate.

23 My assessment is if Mr. Stenberg were to
24 have been fired, the likelihood he would have
25 competed was probably closer to 90 percent or

1 greater, and so to assess the true discount
2 associated with this forfeiture provision would
3 require an assessment independently as to whether he
4 would be fired, whether he'd be fired with cause,
5 without cause, and then would he decide to compete
6 or not. And that calculation I have carried out,
7 and it shows the discount which I applied.

8 Q. Thank you. I show you Exhibit Number 14.

9 MR. DWORK: Can we agree, Mr. Walsh,
10 as to which is the draft and which is the original?

11 MR. WALSH: Yes. 14 is the draft.
12 10 is the basic offer.

13 MR. DWORK: Okay. Thank you.

14 MR. WALSH: That's the one dated
15 September 17.

16 MR. DWORK: Thank you.

17 MR. WALSH: I think what you're
18 looking for, Mr. Dwork, is about four pages in on
19 Exhibit 10.

20 MR. DWORK: Thank you.

21 Q. On Exhibit Number 10 under the term
22 "Offering" it says "Additionally since this is
23 planned to be Staples final equity offering prior to
24 a public offering in mid 1989, we also propose to
25 authorize sufficient common stock to allow for

1 conversion."

2 Sir, do you recall now that it contained
3 that statement?

4 A. I recall reviewing the document, and I see
5 it contains that statement.

6 Q. Do you have any memory at all, sir, as to
7 how much weight at the time that you read this memo
8 you put to it?

9 MR. WALSH: Objection.

10 THE COURT: What's the basis of the
11 objection?

12 MR. WALSH: No relevance what Mr.
13 Romney might have placed on it.

14 MR. DWORK: He's a sophisticated
15 investor, Your Honor.

16 THE COURT: He can have it.

17 MR. WALSH: I'll withdraw it.

18 THE COURT: He can have it.

19 A. It was of interest and usefulness, but I
20 did not place a great deal of credibility in the
21 forecast of the company's future.

22 Q. When -- Strike that.

23 I think you've testified that many times
24 in the past you have reviewed these kinds of
25 offerings, is that correct?

1 A. That's correct.

2 Q. And in about what percentage of cases would
3 you say that the drafter of such a document has
4 suggested that it go public?

5 A. Virtually every one.

6 Q. And in those instances where they suggest
7 that they're going public, how many, what percentage
8 would you say suggests a date that they would look
9 forward to going public?

10 A. I'd say virtually all of them.

11 Q. And sir, what has been your experience with
12 the degree of accuracy that that reflects?

13 A. Probably somewhere between 1 and 10 percent
14 actually are able to go public and become public at
15 some point.

16 Q. And how about meeting their timetable?

17 A. Well, it depends on the time, Mr. Dwork,
18 that you'd be referring to. The further a company
19 progresses, the more likely the forecast becomes.
20 At the very early stage when we receive a business
21 plan, there the likelihood is one out of 100. When
22 the company is further down the road, the
23 probability would increase 25, 35 percent, something
24 of that range, that the company would be able to
25 become public at the time frame and in the price

1 range that someone would have forecasted.

2 Q. I think the term "start-up company" has
3 been used and the term "mezzanine company" has been
4 used with reference to Staples. Can you quantify
5 where you feel it was in September of 1987?

6 A. Yes. I think it was beyond start-up and
7 was at a time of expansion stage. It was in a
8 mezzanine stage, so to speak, of investment.

9 Q. So bearing where it was and what it was, do
10 you have some opinion as to what a sophisticated
11 investor, how much weight he would put to such a
12 statement as to the company going public and when it
13 would go public?

14 MR. WALSH: Objection.

15 THE COURT: What's the basis of the
16 objection?

17 MR. WALSH: First of all, the witness
18 hasn't in his answers to interrogatories or in his
19 deposition indicated an opinion on that topic. That
20 is, what some other hypothetical sophisticated
21 investor would believe about the timing.

22 Secondly, there's no foundation so that
23 this witness could possibly know what's in the mind
24 of those other people.

25 THE COURT: I think the question

1 addressed his. I don't think we're talking about
2 other people.

3 MR. WALSH: I thought it was other
4 people.

5 THE COURT: If it's other people,
6 I'll exclude it. If he's talking about his view,
7 his opinion, he can have it.

8 MR. WALSH: I think it was his
9 opinion as to what others would think. That's the
10 basis of my objection.

11 THE COURT: If that's the question,
12 I'll sustain the objection.

13 Q. Let me ask you about what your opinion was
14 at that stage.

15 A. At that stage I looked at the forecast for
16 the company going public at \$6 a share in roughly
17 the one and a half to two-year time frame, and I
18 assessed the likelihood of that occurring somewhere
19 between 25 and 35 percent.

20 Q. And sir, you were also asked today as a
21 matter of fact about the fact that you felt
22 somebody, and probably Tom, had persuaded Goldman
23 Sachs of the probability of its being able to sell
24 to Sears at a \$100 million frame.

25 First thing, are you familiar with the

1 company Goldman Sachs?

2 A. Yes.

3 Q. And do you know whether it had some sort of
4 a continuing relationship with Staples?

5 A. Yes. We had anticipated -- We had begun
6 working with the company before this time, one, to
7 raise money for us and, two, to consider possible
8 sale options, and we were working with them on that
9 basis.

10 Q. And had Goldman Sachs up to that period of
11 time talked about its being the company responsible
12 for a public offering when Staples was going to go
13 public?

14 A. I was not privy to a conversation with
15 Goldman Sachs to that effect. Mr. Stemberg,
16 however, reported to me that they had a great deal
17 of interest in being associated with the IPO of the
18 company and ultimately were.

19 Q. And what has been your experience with
20 relation to these houses with respect to trying to
21 put through, if you will, the desires of their
22 client if they are anticipating that they might
23 eventually have an initial public offering?

24 A. Goldman Sachs was working with the company
25 on basically all the projects that we desired help

1 on from an investment bank anticipating that
2 something would happen some day for which they would
3 be fairly compensated.

4 Q. Sir, I'd like to go back if I may to
5 September 22, 1987 and suggest to you that that's
6 the date at which the Board of Directors approved
7 the class D as well as the class C offering.

8 THE COURT: I'm sorry, what date?

9 MR. DWORK: September 22, 1987.

10 Q. And sir, were you present at that meeting?

11 A. I believe -- Yes. As a matter of fact, I
12 was present at that meeting although the specific
13 date I don't recall from memory.

14 Q. The meeting suggests that after Mr.
15 Stenberg raised the issue of class D offering, that
16 he was asked to leave the room. Do you have any
17 memory of that?

18 A. I do, yes.

19 Q. And at that time --

20 A. Excuse me. He volunteered that he thought
21 he should leave the room, and he did.

22 Q. And at that time do you recall whether a
23 memorandum from Andrew Nichols concerning the
24 Stenberg's stock transaction was considered by the
25 Board?

1 A. I recall that there was a written document
2 that was considered by the Board, and an oral
3 description was presented I believe by Mr. Nichols.

4 Q. And who was Mr. Nichols?

5 A. Mr. Nichols was counsel to the company at
6 that time.

7 Q. And I show you Exhibit 139 and see if this
8 is the document that was actually presented to the
9 Board?

10 A. This appears to be the document that the
11 Board considered at that time with my notes.

12 Q. They're your notes actually?

13 A. Those are actually my notes to the
14 right-hand side of that document, yes.

15 Q. And do you know when you made those notes?

16 A. I believe I made those notes at the time
17 that this was being considered.

18 Q. May I see it for a moment?

19 A. Yes.

20 MR. WALSH: I wonder if I can look at
21 it, Your Honor.

22 THE COURT: Go ahead.

23 MS. STARR: It's Exhibit 139.

24 Q. Are you able to interpret your
25 hieroglyphics, sir?

1 A. Yes, I am.

2 Q. Would you read them to us?

3 A. Yes. The notes refer to the terms of the
4 class D stock which is no registration rights, no
5 piggyback rights, no vote till converted,
6 liquidation preference, 50 cents preference.

7 Now, there are two lines that I can -- I
8 can almost read, but I can't tell. It looks like
9 converted problem and conference, conf., and I don't
10 recall what those refer to, but I have described the
11 other notes that I can read.

12 Q. Okay. And is it fair to say you were
13 listening to Mr. Nichols explain it, and you made
14 these notes?

15 A. That's correct.

16 Q. Now, the vote, the actual vote -- Strike
17 that.

18 What he says on his written memorandum
19 with respect to convertibility of the stock, he says
20 the new preferred would be nonvoting, would have a
21 liquidating preference junior to that of class A and
22 class B, and would in certain events be convertible
23 into common stock. Is that what he says?

24 A. That's correct.

25 Q. Did you have any discussion -- Do you have

1 any memory of any further discussion by Mr. Nichols
2 just prior to the vote as to what those certain
3 conditions would be?

4 A. No.

5 Q. And then it was voted at the meeting that
6 the advisability of amending and restating the
7 certificates of incorporation of this corporation to
8 create two new classes of preferred stock to be
9 designated class C and class D and consisting of --
10 and I'm leaving out the C stock -- 400,000 shares of
11 class D and otherwise having substantially the terms
12 and conditions presented to this meeting; B, and is
13 hereby declared, and that the officers of this
14 corporation be and thereby are authorized to solicit
15 the written consent of the corporation stockholders
16 to the adoption of such an amended and restated
17 certificate of incorporation. Is that correct?

18 A. You have read it correctly.

19 Q. So when you voted for the approval of the
20 class D stock, did you have any knowledge as to the
21 conditions by which it would be convertible from D
22 to common other than as spelled out in Mr. Nichol's
23 memorandum?

24 A. No knowledge of any other conditions.

25 Q. And how was it left as to who would draft

1 whatever those conditions might be, do you recall?

2 A. Mr. Nichols was to draft those, and we had
3 presumed he would apply conditions standard in such
4 a document.

5 Q. So when you voted for this, was it your
6 understanding that the convertibility would be at
7 the will of the Board of Directors or did you have
8 some other understanding?

9 A. My understanding would be that the
10 convertibility would occur at the public offering of
11 the stock. That's the normal provision under which
12 you can convert a preferred to a common. When the
13 company is ready to go public, you can force the
14 preferred to become common, and that was what was in
15 the back of my mind at that time, but I can't speak
16 as to what the feeling was of the other directors.

17 Q. Well, let's take you as an experienced
18 investor and an experienced business person. What
19 would you think of converting D to common because it
20 might be to the benefit of the common stockholder
21 and to the detriment of the D holder where there is
22 no public offering?

23 MR. WALSH: Objection. What does he
24 think of that? I don't think there's any -- that
25 has any relevance.

1 MR. DWORK: He would be one of the
2 people voting on it probably.

3 MR. WALSH: I thought he just
4 testified -- Maybe I misunderstood. I thought he
5 said that he wasn't aware of that problem when he
6 voted?

7 MR. DWORK: That's correct. Now I'm
8 asking him that's the way the certificate turned out
9 that it says that it's convertible at the will of
10 the Board. So now I'm asking him as a Board member
11 and as an experienced director how would he have
12 felt about voting to make such a convertible
13 transaction at least where the D stockholder had
14 done nothing adverse to the corporation.

15 THE COURT: In the absence of an IPO?

16 MR. DWORK: In the absence of an IPO.

17 THE COURT: You can have it as to his
18 view.

19 MR. DWORK: Yes.

20 A. I would feel that I would be dealing in bad
21 faith. The Board would be dealing in bad faith to
22 subvert the -- If it could do so, I'm not sure it
23 could even do what you're suggesting, but if it
24 could do some documentation that you were
25 suggesting, it would subvert the clear purpose of

1 the preferred D which would give it a liquidation
2 preference senior to the common but junior to A, B,
3 and C.

4 Q. And since it would subvert, what would your
5 reaction be?

6 A. I would being fearful of a lawsuit against
7 me for doing that, I would definitely vote no.

8 Q. Now, sir, there has been -- You have been
9 inquired concerning what you considered to be the
10 risk with respect to the classes of stock in Staples
11 as of September 1987. And I think you've also
12 testified that the return that you were looking at
13 was approximately a 40 percent return, is that
14 correct?

15 A. Yes.

16 Q. Sir, was there some relationship between
17 the risk involved and the return that you were
18 hopeful for in your investment?

19 A. Yes. The rate of return which we use is a
20 shorthand in effect for the degree of risk.
21 Obviously if there is no risk, we're happy with
22 treasury bond rates of return. If there is enormous
23 risk, we look for a higher rate of return. So when
24 we look for a high percentage rate of return, it's
25 indicative of our assessment of the degree of risk.

1 of the positive outcome.

2 So we look as we did at this case at a
3 future value of if everything works, if the dream
4 comes true of \$6 a share, and then say what are the
5 probabilities that that will occur, what are the
6 probabilities that bad things will occur, and then
7 that assessment allows us to choose a discount rate
8 or in effect a blending of all of those
9 probabilities to assess what rate of return we --
10 excuse me -- we require for an investment in that
11 company.

12 Q. And sir, with respect to a 40 percent
13 return on your investment or proposed or hoped for
14 40 percent return on your investment, how would you
15 categorize that kind of a risk?

16 A. I think anyone who is looking for a 40
17 percent rate of return on their money is probably
18 investing in something with a very high degree of
19 risk. And if you know of investments where you can
20 get anywhere near that rate of return at low risk,
21 I'd appreciate hearing more about them. Very high
22 rate of risk situation.

23 MR. DWORK: Thank you. I have no
24 further questions.

25 THE COURT: All right, Mr. Walsh.

RE CROSS EXAMINATION

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EXAMINATION BY MR. WALSH:

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Q. How about one then, Mr. Romney, in which you already own the stock that you think 40 percent rate of return is appropriate for and you don't have to pay any money to get it, you'd like that, wouldn't you?

9

A. If you can rephrase the question.

10

MR. DWORK: I don't understand.

11

12

13

14

15

Q. Sure. Suppose you already had a claim to 2.2 million shares of common stock, all right, and you don't have to pay any more money to get it. You already have a basis to claim you're entitled to all or some of it.

16

17

18

THE COURT: When you say "you," I'm not sure I understand it either. Talking about Mr. Stemberg already owning 2.2 million common shares?

19

20

21

22

23

Q. Sure. You suggested that you'd like to know if you could get a 40 percent rate of return on a low risk kind of investment. You'd like to hear about that, right? Sounds like a good deal to you, right?

24

A. I think so, yes.

25

Q. Let me propose one to you. Suppose you

1 already have a claim on all or some portion of
2 2.2 million shares of common in September of 1987.

3 A. Right.

4 Q. And in order to acquire actual rights to
5 all or any portion of it you don't have to pay any
6 money.

7 A. Right.

8 Q. All right. Now, assuming that you're
9 successful in closing such a deal, you will have the
10 stock which you think a 40 percent rate of return is
11 appropriate for in weighing the risks and the
12 rewards, right?

13 MR. DWORK: I pray Your Honor's
14 judgment.

15 MR. WALSH: He opened that, Your
16 Honor.

17 MR. DWORK: I know I opened it.

18 THE COURT: He opened it, but what's
19 the objection?

20 MR. DWORK: My objection is, A, that
21 he assumes Mr. Stemberg didn't pay anything for it.
22 And, of course, what Mr. Stemberg paid for was two
23 or three years of his life. But secondly, it
24 doesn't matter what the consideration was for it.
25 If today it is worth X dollars, let's just pick a

1 figure \$2 for lack of another figure, if it's now
2 worth \$2, Mr. Stemberg has \$2 on the table. The
3 question is does he risk it into the future or does
4 he not risk it into the future because no matter
5 what Mr. Stemberg paid for it this is supposedly
6 what it's worth. We say it's worth 50 cents. They
7 say it's worth \$2.25. But whatever that figure is,
8 Mr. Stemberg now has that asset, and the question is
9 what is his risk by holding it two years in the
10 future? Will it go down? Will it go up? So it
11 really is irrelevant what he paid for it. What's
12 important is what he's got.

13 MR. WALSH: I know Mr. Dwork doesn't
14 like the analogy, Your Honor, but what he said has
15 nothing to do with the question.

16 MR. DWORK: Of course it does.

17 THE COURT: I don't think you
18 finished the question. Why don't you go ahead and
19 rephrase it.

20 Q. Sir, if you're in the position that I just
21 suggested --

22 THE COURT: You're asking him a
23 hypothetical question.

24 A. In your hypothetical question I have
25 2.2 million shares.

1 Q. No. You have a claim to get all or some
2 portion of 2.2 million shares.

3 THE COURT: He has not yet vested, is
4 that what you're suggesting when you say "a claim"?

5 Q. Let me be more direct. Let me change the
6 hypothetical a little bit. It might help you.

7 A. Okay.

8 Q. You're an investment banker. In fact,
9 you're actually a lawyer, nonpracticing lawyer,
10 right?

11 A. Right.

12 Q. Mrs. Stemberg comes in to see you, Maureen?

13 A. Right.

14 Q. And Maureen tells you that she's in a
15 situation where she's got a claim on 2.2 million
16 shares of common stock which if she's successful in
17 her claim she will be able to obtain all or some
18 portion of them and not have to pay any money for
19 it. Now, that sounds like a pretty good deal to you
20 so far, right?

21 A. Certainly.

22 Q. Sure. Because in your view the correct
23 hurdle rate or rate of return that you want to see
24 given the risks and the rewards is about 40 percent
25 in September of 1987, right?

1 A. Yes. Although I'm missing something. She
2 doesn't have to pay anything for this claim, right?

3 Q. Right.

4 A. If they're worth \$1, it's a good deal to
5 you.

6 Q. Sure. You'd agree with that, wouldn't you?

7 A. Right. I mean, if total they're worth \$1,
8 it's a good deal.

9 Q. Sure. So what your analysis is looking at
10 when you're talking about a 40 percent rate of
11 return or any other hurdle rate, you're looking at
12 it from the standpoint of you, Mitt Romney, as
13 someone who's about to buy that stock whether or not
14 it's going to meet your hurdle rate?

15 A. That's how the market works.

16 Q. Okay. Now, what I'm suggesting to you is
17 the reverse. You already own it. The question now
18 is do you want to sell it?

19 A. Correct.

20 Q. All right. Now, in your experience at Bain
21 you bought the stock in three separate -- you bought
22 preferred at least in three separate rounds, right?

23 A. Right.

24 Q. A, B, and C, right?

25 A. Right.

1 Q. You sold none of those prior to the public
2 offering, is that right?

3 A. I didn't have a choice. I didn't sell any.

4 Q. You didn't sell any of them, and when you
5 recommended to your partners whether or not to buy
6 or not to buy in those three rounds, you factored
7 into your thinking the fact that at least as far as
8 you knew you were not going to be able to sell those
9 shares prior to a public offering or a sale of the
10 company?

11 A. Most likely I wouldn't be able to.

12 Q. Okay. So when we got to -- Let me strike
13 that.

14 When you testified a moment ago that the
15 40 percent rate of return was I think a shorthand
16 expression I think is what you said for risk?

17 A. Right.

18 Q. It's also a shorthand expression for the
19 reward, isn't it?

20 A. Yes.

21 Q. And you also acquired in the course of your
22 dealings with Staples certain options to common
23 stock, did you not?

24 A. We --

25 Q. By "you" I mean you or Bain.

1 A. Yes.

2 Q. And did you also acquire some common shares
3 as sort of a reward or compensation for your good
4 deeds on behalf of the corporation?

5 A. I believe I did, yes.

6 Q. And you didn't sell any of that, did you,
7 prior to the IPO?

8 A. They were nontransferable.

9 Q. You made no effort -- When you say they're
10 not transferable, sir, the truth of the matter is
11 there are certain circumstances under which you can
12 transfer those shares if you wish, aren't there?

13 A. To my children and wife, yes.

14 Q. And there are other -- Did you sign, by the
15 way, contracts similar to what Mr. Stemberg signed
16 restricting transfers on your stock?

17 A. I would have to look at the restriction. I
18 really can't respond to that other than to say that
19 I know that my stock was subject to transfer
20 restriction.

21 Q. And did you --

22 THE COURT: Excuse me a minute. Was
23 your stock purchased or was it given in exchange for
24 services rendered as a director?

25 THE WITNESS: It was purchased.

1 Common stock was purchased.

2 THE COURT: Common stock was
3 purchased?

4 THE WITNESS: That's correct.

5 Q. When you say it was purchased, you
6 individually purchased it?

7 A. That's correct. I purchased I believe
8 30,000 or 40,000 shares of common stock, and it was
9 subject to a repurchase by the company, and I could
10 not transfer those shares, and if I left the Board
11 as a director they could be repurchased by the
12 company as well.

13 THE COURT: Do you recall what you
14 paid for those shares?

15 THE WITNESS: A very small amount.
16 And I don't recall the amount, but it's the same
17 value that the other common was trading for at the
18 time. You know, a few millionths a share or
19 something of that nature.

20 THE COURT: Less than a penny a share?

21 THE WITNESS: Yes.

22 Q. That's in fact what Mr. Stemberg did, isn't
23 it, he bought his stock?

24 A. That's correct.

25 Q. Although at a relatively nominal price?

1 A. That's correct.

2 Q. And he bought his in January of 1986
3 simultaneously with signing his restriction
4 contracts, right?

5 A. To the best of my recollection, yes.

6 Q. Now, did you sign restriction contracts
7 similar in nature to what Mr. Stenberg signed in
8 this case that you reviewed?

9 A. Depends on what you mean "similar in
10 nature." I know that if you'll ask me --

11 Q. Did you sign a stock transfer restriction
12 agreement?

13 A. I believe so, yes.

14 Q. And were the terms of restriction identical
15 to those of Mr. Stenberg?

16 A. I don't know.

17 Q. Did you sign a holdback agreement with the
18 company, not with Goldman Sachs, but with the
19 company?

20 A. The company had the right to repurchase my
21 shares if I left or were fired as a director if
22 that's what you mean by holdback agreement, yes.

23 Q. That's a different kind of an agreement.

24 A. Okay.

25 Q. So you had one of those?

1 A. Yes.

2 Q. Did you have a co-sale agreement that had
3 the same terms as Mr. Stenberg?

4 A. I don't believe so.

5 Q. Now, in terms of the rate of return of 40
6 percent, I think you testified just a moment ago
7 that the rate of return is something that you look
8 at in analyzing a prospective investment to see
9 whether or not it meets minimum rate of return that
10 you want, right?

11 A. That's correct.

12 Q. And of course, it could produce a much
13 higher rate of return, and that would still satisfy
14 you in determining whether or not to buy, right?

15 A. Absolutely.

16 Q. So if you ran your calculations and looked
17 to you like the rate of return was going to be say
18 60 or 70 percent, that's not a problem as far as
19 you're concerned in September of 1986, is it,
20 because you met your minimum of 40 percent?

21 A. It's never a problem.

22 THE COURT: You mean '87?

23 MR. WALSH: '87. I'm sorry. Thank
24 you, Your Honor.

25 MR. DWORK: Your Honor, of course it

1 makes a difference whether it's preferred stock or
2 common stock.

3 MR. WALSH: Your Honor, he's arguing.

4 MR. DWORK: No, but the incidence of
5 the stock is different then, and it's been testified
6 that common gets a higher return than preferred
7 because there's higher risk. That's been testified
8 to.

9 THE COURT: I'm not sure if you're
10 asking -- When you say what his recommendation to
11 his investment group, I assume you're referring to
12 class C, aren't you, preferred?

13 MR. WALSH: The group had no right to
14 purchase common.

15 Q. With whatever stock they purchased, sir.
16 When you recommend to your partners at Bain a
17 particular investment, in this case an investment in
18 Staples, what you do in determining whether or not --
19 First of all, I think you told Mr. Dwork that you
20 felt that this company was a mezzanine company,
21 right?

22 A. That's correct.

23 Q. And therefore, you felt that by September
24 of 1987 approximately a 30 to 40 percent rate of
25 return was what you would demand, is that right?

1 A. Roughly, yes.

2 Q. And that's down from what it had been in
3 the prior rounds, what you had demanded in the prior
4 rounds as a rate of return, right?

5 A. That's correct.

6 Q. And that's because the risk was down by
7 September of 1987 from where it had been?

8 A. That's correct.

9 Q. Now, in assessing whether or not you're
10 going to meet this minimum rate of return, when you
11 do your calculation it's true, is it not, that in
12 the event that your anticipated -- your calculation
13 of what the anticipated future value of the company
14 is, okay, at the point in time where you expect it
15 to happen, assuming for a moment that produces an
16 indicated rate of return of let's say 60 percent,
17 all right, in September of 1987, that's certainly
18 acceptable to you because it's above your minimum,
19 right?

20 A. Anything above the minimum would be
21 acceptable if that's what we concluded.

22 Q. Now, when you voted on the class D --

23 A. Yes.

24 Q. -- Mr. Dwork asked you some questions about
25 the Nichols memorandum, and I think you told me that

1 Strike that.

2 Did you tell Mr. Dwork that when you
3 voted on to approve the D round that you didn't know
4 about the reverse conversion right if we can call it
5 that? That is the right the company had to compel a
6 conversion of D into common. Is that what your
7 testimony is?

8 A. The testimony is that I -- The rights of
9 the conversion, the specific rights of conversion I
10 did not understand other than what is shown in the
11 document, and that that document gave rise in my
12 mind to a belief that there would be conversion upon
13 an IPO, but another basis would not have been a good
14 faith conversion so far as I knew at that point.

15 Q. So when you read the Nichols memorandum,
16 you understood that there would be a conversion or
17 at least there could be a conversion?

18 A. Under certain circumstances.

19 Q. In the event the company went public or was
20 sold, right? You understood that conversion?

21 A. That's right.

22 Q. But your testimony is at the time you
23 approved the decision to have a class D, you did not
24 know about a second conversion, this one being
25 mandatory at the company's option at any time?

1 A. I was not aware of that, that's correct.

2 Q. You were not aware of that?

3 A. That's correct.

4 Q. Now, sir, at the time of the meeting --
5 Strike that.

6 Did you make the notes, the handwritten
7 notes, that you identified for Mr. Dwork on the
8 Nichols memo at the time of the meeting?

9 A. I believe so, yes.

10 Q. And one of the notes that you had was 50
11 cents preference, is that right?

12 A. Right.

13 Q. And that 50 cents preference refers to the
14 liquidation preference that the D had, correct?

15 A. Correct.

16 Q. Ahead of common?

17 A. Yes.

18 Q. And now you only made, what, five notes on
19 this document?

20 A. That's correct.

21 Q. And that was the last note you made, and
22 you underlined the word preference, didn't you?

23 A. Yes.

24 Q. And the net effect as you've now come to
25 learn of the company's right to compel a conversion

1 from D back to common is if the company were to do
2 it is to wipe out that liquidation preference?

3 A. I don't believe that's the net effect, no.

4 Q. You don't believe that's what happens if
5 you convert D into common?

6 A. No. You said that was the net effect of
7 the provision. I said to do so would have been bad
8 faith, would have subjected me to suit.

9 Q. This is a different question. You have now
10 come to understand that in the event the company
11 exercised its right to compel a conversion from D to
12 common, the effect would be to eliminate the 50
13 percent preference that D otherwise had, right?

14 A. If the company were to do that, it would
15 have the effect of eliminating the 50 cents
16 difference, that's correct.

17 Q. And that's why you made the note 50 cents
18 preference underlined at the time of the meeting,
19 isn't it?

20 A. No.

21 Q. Weren't you concerned that in the event
22 such a conversion were to take place one of the D
23 shareholders might bring suit?

24 A. Absolutely not.

25 Q. Weren't you concerned, sir, that by

1 creating a class D in the first place that had the
2 liquidation preference of 50 cents and placing it
3 ahead of the common shareholders, that that might
4 bring a suit from the common shareholders in --

5 A. No.

6 Q. -- in the event the company was liquidated
7 and that preference kicked in?

8 A. No.

9 Q. Wasn't that the whole reason why you wanted
10 to make sure -- you and the other members of the
11 Board wanted to make sure that the company could
12 always get out of that problem simply by reserving
13 the right to convert the D back to common in the
14 event that liquidation preference was about to come
15 into play?

16 A. No.

17 Q. Now, sir, in truth you don't have any
18 memory of the discussion at the Board meeting about
19 this memo, do you?

20 THE COURT: Present memory today?

21 MR. WALSH: Present memory, yes.

22 A. I'm not quite sure what you mean no memory.
23 I recall that the memo was distributed, that Mr.
24 Nichols described the provisions, that I took notes
25 as to what those provisions were, and I have a clear

1 memory as to what I thought about the fairness of
2 the deal.

3 Q. And with regard, sir, to the --

4 A. And I do recall what was discussed and
5 which topics were discussed with regard to the
6 provisions of class D.

7 Q. One of the things that you wrote on the
8 Nichols memorandum -- I guess it's in your
9 handwriting, sir. Do you still have it with you?

10 A. I do not.

11 Q. I'll show it to you. There's handwritten
12 on the top November 17 at 9:00 a.m. Do you see that
13 in the middle?

14 A. Yes.

15 Q. Is that in your handwriting, sir?

16 A. Yes, it is.

17 Q. That was a reference as to when the next
18 meeting was going to be of the Board, wasn't it?

19 A. I don't recall.

20 Q. In any case, sir, at the time of the Board
21 meeting on September 22, 1987 did you have with you,
22 sir, at that meeting the text of the terms and
23 conditions which would govern this new class of
24 securities, both the C and the D?

25 A. As of what -- As of which meeting?

1 Q. September 22nd.

2 A. Did we have the text with us at that
3 meeting?

4 Q. Yes.

5 A. I don't believe so, but I don't recall.

6 Q. You've seen the text of those provisions
7 attached to the minutes of that meeting, have you
8 not? In fact incorporated into them.

9 A. I may have. I don't recall.

10 MR. WALSH: I wonder if we could have
11 that, Your Honor. Mr. Liebert can find it.

12 A. I don't object to that concept.

13 Q. In November of 1987 you had another Board
14 meeting, and you attended that one, didn't you, sir?

15 A. I believe so, but I don't have present
16 memory as to the specific date.

17 Q. And one of the first things that you did at
18 the September 1987 -- at the November, I'm sorry,
19 November --

20 THE COURT: What date in November was
21 that?

22 MR. WALSH: I believe it was the
23 17th, Your Honor. The particular day may be wrong.
24 That's the next set of minutes I will need.

25 Q. Sir, to keep this in order now that we have

1 the September 22 Board minutes, let me direct your
2 attention if I can, this is Exhibit 129 I believe,
3 let me direct your attention to pages basically 10,
4 11, 12, and 13.

5 MR. DWORK: May I see it because I
6 don't seem to have a copy.

7 MS. STARR: We don't have anything
8 attached.

9 MR. DWORK: Before you answer any
10 questions, I'd like to look at it.

11 A. I see the document.

12 MR. DWORK: May I see it?

13 MR. WALSH: Sure.

14 MR. DWORK: Thank you.

15 Q. Now, the first order of business, sir,
16 first of all, you voted to approve C and D, did you
17 not, at the September 22 meeting?

18 A. Yes.

19 Q. And then come November 1987 one of the
20 first orders of business at that meeting was to
21 approve the minutes of the September meeting, wasn't
22 it?

23 A. Yes.

24 Q. And you did vote to approve the minutes of
25 the September meeting, didn't you, sir?

1 A. Yes.

2 Q. At some time you suggested to Mr. Dwork --
3 Let me strike that, Your Honor.

4 MR. DWORK: Your Honor, unless I'm
5 sorely mistaken, I don't see a vote approving the
6 meeting of September 17, and I don't --

7 THE COURT: I'll tell you what.
8 We'll take the morning recess now anyway. Why don't
9 you compare the two Board meetings. Perhaps counsel
10 can agree on whether it's there or not. Take a
11 short morning recess.

12 MR. WALSH: I wonder, Your Honor,
13 apropos of that I wonder if we could have the entire
14 minutes of November 17. What we have is redacted as
15 Your Honor may recall by Staples counsel. I wonder
16 if Mr. Dwork might share with us the whole document.
17 It might help us.

18 MR. DWORK: I don't think I have it.

19 THE COURT: Well, I assume there was
20 some Board meeting minutes put into evidence
21 already.

22 MR. WALSH: And I believe those were
23 among them, yes, Your Honor, but I believe that Your
24 Honor will see that those are redacted to some
25 degree.

1 MR. DWORK: I don't see that it is.

2 THE COURT: Is there anything that
3 was critical?

4 MR. DWORK: Yes, I'm sorry, there is
5 a paragraph missing.

6 THE COURT: Was there anything
7 critical to this case that was redacted out?

8 MR. WALSH: It's possible that that's
9 where the reference to the actual affirmance of the
10 prior Board minutes are. This witness testified it
11 happens.

12 MR. DWORK: Your Honor, I do object
13 to my brother looking at a document like this and
14 then saying to the witness "And the meeting of
15 November 17th approved the meeting of September
16 12th" when it doesn't appear here. I mean, that
17 really --

18 THE COURT: If it doesn't appear, I'm
19 not going to make the assumption that because
20 information was redacted that's what was redacted.
21 And it seems to me that any redactions were with
22 agreement of counsel as I understand it. I thought
23 the purpose of the redaction of some of these
24 meetings were to protect Staples from competitors or
25 any other information.

1 MR. WALSH: That may have been
2 Staples purpose, Your Honor, but the redaction was
3 done without us first seeing what was in it. The
4 redactions were made by Staples counsel that they
5 had no bearing on the case. I take that to mean,
6 and we accepted that at face value at the time as
7 meaning such things as any potential deals, for
8 example, that's unrelated to this that they might be
9 contemplating, something like that.

10 The difficulty is if there was something
11 as really minimal as simply the approval of the
12 prior minutes of the Board of Directors meeting, I
13 don't know if they might have taken that out or not.
14 I just don't know.

15 MR. DWORK: Nor do I.

16 MR. WALSH: And I suggest Mr. Dwork
17 doesn't know it either for the same reason, he
18 didn't see them beforehand either.

19 THE COURT: Why is there any concern
20 whether the minutes were approved or not anyway?
21 You have the minutes. That's what the Board voted.
22 Nobody has -- Apparently there's no evidence that
23 anybody presented some form of motion during a
24 meeting to vacate the minutes or correct the
25 minutes.

1 MR. WALSH: That's our point exactly,
2 Your Honor.

3 THE COURT: I'm going to assume the
4 minutes accurately state the decision of the Board.

5 MR. WALSH: Thank you, Your Honor.
6 That's fine.

7 THE COURT: We'll take a short
8 recess.

9 MR. WALSH: Thank you.

10 (Whereupon, a recess was taken.)

11 Q. Mr. Romney, back on the Nichols memorandum
12 for a moment, the second line of what you handwrote
13 I think is one of the ones that you can't read.

14 A. I can read it now.

15 Q. You can read it now?

16 A. Converted when public. Converted public.

17 Q. Converted public?

18 A. Yes.

19 Q. Not conversion problem?

20 A. No. Converted public. No vote till
21 converted.

22 Q. That's the next line?

23 A. Yes. Liquidation preference. It's the
24 conf., I'm just wondering what that is. And then 50
25 cents preference. The only one I can't figure out

1 there is the conf., and I don't know what that
2 refers to.

3 Q. Is the conf. a reference to confirm 50
4 cents preference?

5 A. No, I don't believe so.

6 Q. You don't think so?

7 A. No.

8 Q. Okay. In any case, sir, you told Mr. Dwork
9 that you were familiar with the round C memo, and I
10 think you said that you had read it. Had you read
11 it by the time of the September meeting, September
12 Board meeting?

13 A. I'm sorry, I don't recall.

14 Q. All right.

15 THE COURT: You mean the draft of the
16 memo?

17 MR. WALSH: No. The actual memo.

18 Q. You recall, sir, if we can look at Exhibit
19 10 again that Mr. Dwork showed you, the C memo is
20 actually dated September 17, 1987, right?

21 A. Yes.

22 Q. And the reference to the final offering
23 prior to a public offering in mid 1989 is about four
24 pages in on that document, right?

25 A. That's correct.

1 Q. Now, had you read this September 17
2 document, Exhibit Number 10, by the time of the
3 September 22 Board meeting some five days later?

4 A. It's probable, but I don't have present
5 memory as to whether I had read it by that meeting.

6 Q. In any case, at the meeting you voted to
7 approve the issuance of this preferred stock, didn't
8 you?

9 A. I believe that was part of the September
10 22nd meeting, yes.

11 Q. And when was the first time that you recall
12 seeing this particular reference to a final equity
13 offering prior to a public offering in mid 1989?
14 When's the first time you do recall seeing that?

15 A. Well, it would have been prior to that
16 meeting.

17 Q. Okay. And "that meeting" meaning the
18 September 22 meeting, right?

19 A. That's correct. What I mean by that is --
20 Let me clarify my answer. I don't mean necessarily
21 I would have read that sentence, but the concept of
22 a public offering sometime as of the date that
23 you're referring to there in the memo would have
24 been discussed by us prior to that meeting.

25 Q. And when did you become aware that that

1 specific representation actually appeared in the
2 document that was to be circulated to potential
3 investors?

4 MR. DWORK: Well, Your Honor, I
5 object. I object on the grounds that
6 "representation" has a legal connotation, and I
7 suggest this is not a representation but a statement
8 of intent, but it isn't a representation which is
9 similar to a warranty.

10 Q. Well, if I may, the statement that I'm
11 referring to, Mr. Romney, I'll read it, is
12 "Additionally since this is planned to be Staples
13 final equity offering prior to a public offering in
14 mid 1989." That's the part that I'm referring you
15 to, sir.

16 When did you first become aware that that
17 statement, if we can call it that, was in the round
18 C memo?

19 A. Whenever I first read the round C memo
20 which was before I made the decision to invest in
21 it, and I don't recall -- It was in or around the
22 September 22nd time frame.

23 Q. And after you read it, sir, did you make
24 any motion or take any action to get that statement
25 removed from the memo that was to be circulated to

1 the investors?

2 A. No.

3 Q. And in fact, this document, the whole
4 purpose of Exhibit 10 is to circulate it to and
5 among potential buyers of the class C, right?

6 A. I believe so. Yes.

7 Q. And you talked about the long odds, if we
8 can characterize it as that, about a company being
9 able to go public at least at the time frame that it
10 states. Do you recall that?

11 A. Yes. In the case of a start-up, I'm
12 talking about very long odds with a start-up.

13 Q. And less long when it gets to be a
14 mezzanine company, right?

15 A. That's correct.

16 Q. Which this was according to your testimony?

17 A. That's correct.

18 Q. And in this particular case, that is the
19 case of Staples, sir, it's true, is it not, that the
20 planned IPO date of mid 1989 was a plan that
21 management had had going back to approximately
22 September or October of 1986, isn't that so?

23 A. I don't believe we were that specific as to
24 when we thought we would be able to go public if we
25 achieved the dream, but I don't doubt that.

1 Q. Well, do you recall in the --

2 A. The original plan showed a great deal more
3 profitability earlier, and we scaled back those
4 plans significantly as we went along.

5 Q. Do you recall in the September -- rather
6 the October 1986 second round financing memorandum
7 that that memorandum said "We shall plan to go
8 public during the spring of 1989"?

9 A. If that's what it says. I don't have a
10 present recollection of the memo, but if that's what
11 it says, that's fine.

12 Q. And you read that memo, didn't you?

13 A. Yes.

14 Q. And you didn't take any steps with respect
15 to that memo to remove that statement, did you?

16 A. No.

17 Q. That memo was circulated among investors,
18 was it not?

19 A. Yes.

20 Q. And so you knew then in September of 1987
21 when the round C came out that that had been the
22 plan of the company from approximately October 5,
23 1986 to September 22, 1987, didn't you?

24 A. Yes.

25 Q. So that plan had been in place at that

1 point in time, sir, for approximately a year, hadn't
2 it?

3 A. The term "plan" is a bit overstated, but
4 yes.

5 Q. Well, overstated. That's the word they
6 used, isn't it?

7 A. You can read it again. We can find out if
8 that's the word they used.

9 Q. And did you tell your partners that when
10 you were telling them whether or not you ought to
11 make this investment, did you tell your partners
12 that you didn't believe that plan, it wasn't going
13 to happen?

14 A. Yes.

15 Q. You did?

16 A. Yes, absolutely.

17 Q. And you have a record of that somewhere?

18 A. No. I don't have to have a record to
19 testify.

20 Q. As a matter of fact, you're the one who
21 didn't have the investment memos, right, written
22 investment memos to produce for this case, did you?

23 A. We have no written investment memos on any
24 investments we make.

25 Q. And you don't have the slides that you used

1 to make your presentation either?

2 A. Not on subsequent rounds.

3 Q. So the plan in 1986 and in 1987 to go
4 public in mid 1989, in fact that's what happened,
5 isn't it, sir?

6 A. Approximately that's the date I believe,
7 yes.

8 MR. WALSH: No further questions,
9 Your Honor. Thank you.

10 THE COURT: This is going to be the
11 last round. This will be the re-redirect and then
12 be a re-recross. You'll have the last word, Mr.
13 Walsh, and that will be it.

14
15 FURTHER REDIRECT EXAMINATION

16
17 EXAMINATION BY MR. DWORK:

18 Q. Have you now had a chance to review the
19 meetings of September 22 and November 17?

20 A. No. I will take a look.

21 Q. You were asked about some --

22 A. I reviewed the documents that were handed
23 to me during our last session, yes.

24 Q. You were asked whether some appendage to
25 the meeting of September 22 set forth in greater

1 detail the incidence of ownership in the class D
2 stock.

3 Do you see anything other than what we've
4 already discussed as to the characteristics of that
5 stock?

6 A. No.

7 Q. And in the November meeting Mr. Walsh
8 suggested that there was a meeting -- that there was
9 a vote affirming the earlier meeting. Does that
10 appear there?

11 A. It doesn't appear here so far as I find it
12 although that was customary.

13 Q. And do you see anything in that second
14 meeting which further characterizes the or further
15 describes the characteristics of the class D stock?

16 A. Not further than we have already reviewed,
17 no.

18 Q. Thank you. Now, you say that before making
19 the investment in Staples round C you read the
20 statement "Additionally, this is planned to be
21 Staples final equity offering prior to a public
22 offering of mid 1989." And you say that you did not
23 strike that. You say you read that statement.

24 Let me ask you this, sir. Did you,
25 therefore, as a result of that subscribe to the full

1 amount to which you were entitled to subscribe?

2 A. I did not.

3 Q. And why was that, sir?

4 A. Because while I believed that there was a
5 realistic probability that we would achieve that
6 outcome, there was also a realistic probability that
7 we would either lose our money or we would achieve
8 something less than that. And my personal
9 assessment and that of my partners was that the risk
10 that we would not achieve the plan was high enough
11 that we should not subscribe to our full amount.

12 Q. And you did not subscribe to the full
13 amount?

14 A. We did not subscribe to the full amount.

15 MR. DWORK: Thank you very much.

16 THE COURT: All right, Mr. Walsh.

17 MR. WALSH: Thank you, Your Honor.

18

19 FURTHER RECROSS EXAMINATION

20

21 EXAMINATION BY MR. WALSH:

22 Q. Mr. Romney, with regard to not subscribing
23 to your full allotted amount, in fact, sir, there
24 was a plan to bring on new investors in that round,
25 wasn't there?

1 A. Yes.

2 Q. And in order to do that, if everybody had
3 bought their full allotted amount, there wouldn't be
4 any room for the new investor, would there?

5 A. There wouldn't have been any need for any.

6 Q. That's right. So in order to bring a new
7 investor on, people had to take less than had been
8 previously subscribed to, didn't they, sir?

9 A. No.

10 Q. As a matter of fact, sir, in 1986, November
11 of 1986, do you recall in connection with the round
12 B financing that there was a plan in place for each
13 of the potential investors to buy less than their
14 fully allotted amount so that additional people
15 could be brought in?

16 A. I don't recall that with regard to round B.

17 Q. Do you recall -- Are you familiar with the
18 investment memorandum of Mr. Hardyman, Mr.
19 Stemberg's --

20 A. No, I'm not familiar.

21 Q. And you don't recall a discussion with Mr.
22 Hardyman about that subject?

23 A. I recall a discussion with Mr. Hardyman
24 with regard to their investment in round B.

25 Q. And as a result of that discussion, sir,

1 isn't it the case that the company had decided and
2 requested that various investors including Mr.
3 Hardyman buy less than the fully allotted amount so
4 that there would be room for additional investors?

5 A. No.

6 MR. DWORK: Objection. I'll withdraw
7 it.

8 A. No. To be specific, Mr. Stenberg asked us
9 what our investment intention --

10 Q. Sir, you've answered the question.

11 A. Okay.

12 Q. The answer was "No."

13 Now, it's true, is it not, that all the
14 rounds including the C was oversubscribed?

15 A. Yes, ultimately. I believe that's true.

16 MR. WALSH: Nothing further. Thank
17 you. Thank you, Mr. Romney.

18 MR. DWORK: Thank you, Mr. Romney.

19 THE COURT: Thank you. You may step
20 down.

21 THE COURT: All right. Mr. Walsh,
22 it's still part of your case in chief.

23 MR. WALSH: Yes, Your Honor. We had
24 this discussion if you recall on Friday. I
25 understand that my brother is going to be calling