



DEPARTMENT OF JUSTICE

Antitrust Division

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Michael M. Briley, Esq.
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North Courthouse Square
1000 Jackson
Toledo, Ohio 43624-1573

Dear Mr. Briley:

This letter responds to your request on behalf of Depot Direct, Inc. ("DD") for the issuance of a business review letter pursuant to the Department of Justice's business review procedure, 28 C.F.R. § 50.6. You have requested a statement of the Department's current enforcement intentions regarding the creation and operation of DD as a distributor of industrial products in the manner described in your request. Based on the information and assurances that you have provided, the Department has no current intention to challenge the proposed organization and operation of DD.

According to your representations, DD will be organized by an initial group of investors to perform central warehousing and distribution functions for various industrial products. You assert that the traditional distribution paradigm in which manufacturers sell products to authorized distributors who resell to other vendors as well as end-users is relatively inefficient for all parties concerned. Under current distribution channels, you believe that manufacturers incur high distribution costs because they deal directly with a large number of distributors. At the same time, end users incur high transaction costs because they must deal with different authorized distributors for each type of industrial product. Finally, you suggest that distributors, faced with warehousing the large inventories needed to provide "just-in-time" delivery, also incur higher than desirable costs because they do not capture economies of scale or scope. In contrast, you assert the belief that DD will be able to offer improved delivery and better prices for all the parties in the distribution chain -- manufacturers, distributors and end users -- by capturing economies of scale, scope and specialization.

You have indicated that DD initially will be owned by about 18 investors who will provide an initial capitalization of \$3 - 3.5 million. The initial investors will be made up of persons involved in or knowledgeable about the markets involved, e.g., authorized distributors of some of the industrial products involved and others interested in developing the wholesaling and distributional concepts that DD will utilize. It is contemplated that the initial private financing will be followed by an initial public offering that will substantially broaden ownership of DD. From its inception, however, DD will have a management independent of its initial trade/investor owners and a Board of Directors on which directors selected by the initial trade investors will not constitute a majority.

DD plans to purchase industrial products from individual manufacturers on a negotiated basis. All pricing negotiations with manufacturers will be conducted by representatives of DD who are not employed by any investor/distributor or customer of DD. The terms of DD's purchases will be kept confidential from DD's customers and industry investors. It is contemplated that initially one manufacturer per product group will be selected, but DD may utilize multiple suppliers for various products in the future. It is anticipated that, at least initially, DD will pay certain refunds annually to its manufacturer/suppliers based on DD's profitability and the amount of the individual manufacturer's product sold by DD to its customers.

It is contemplated that DD will sell to five general categories of customers: authorized distributors (selected by the manufacturer), resellers, end-use customers, consolidators and integrators. DD will play no role in any manufacturer's selection of its "authorized" distributors; nor will it involve itself in determining the terms or conditions on which any distributor resells the products supplied by DD. All customers will be required to prepay an annual fee. Those who are willing to commit to an annual volume of purchases from DD will be designated "members" and will be entitled to a year-end bonus, based on DD's profitability and their purchases, and a reduced annual fee. "Membership" will be equally available to all customers. Customers who choose not to make an annual purchase commitment, can buy as much or little as they choose, but will not be eligible for the reduced annual fee or a year-end bonus. The formula for determining annual fees will be uniform and available to all customers. All of DD's pricing to its customers will be consistent with the Robinson-Patman Act. All customers will remain free to purchase any product carried by DD from any other source of their choosing. DD's decisions on price to its customers will be made by DD management personnel, i.e., individuals not employed by its investors or customers, and all communications between DD and its customers relating to the latter's business practices will not be disclosed to DD's other customers or investors.

Initially, DD plans to sell industrial products from the following product category groupings: hydraulic pumps; hydraulic motors; pneumatic air motors; hydraulic valves; pneumatic valves; actuators; hydraulic filters; pneumatic filters; hydraulic and pneumatic hose/fittings; accumulators; heat exchangers; electric motors; ball valves, flanges; sensors; gauges; accessories; replacement parts; aftermarket replacement products; and other pneumatic

products. Additional products may be carried over time. You estimate that even if DD's operational plans are fully realized, its purchases would account for less than ten percent of U.S. purchases of its product lines on average, and would not exceed eighteen percent of any product line.

On the basis of the information, predictions and assurances that you have provided to the Department, it does not appear that the initial organization or planned operation of DD would raise antitrust concerns. The procedures proposed to assure that DD will be managed and operated as an entity independent of its customers and investors, the preservation of customers' purchasing prerogatives, and the measures that will be adopted to keep pricing information confidential should avoid antitrust risks of either a horizontal or vertical nature. Moreover, DD's predicted share of the affected product markets would not be large enough to enable it to exercise either monopsony purchasing power vis a vis its product manufacturer suppliers or market power as a seller to its various customers.

To the extent that DD's operations are characterized by efficiencies that generate cost savings for its customers, its activities could have the procompetitive effect of increasing output.

This letter expresses the Department's current enforcement intentions, and is predicated on the accuracy of the information and assertions that you have presented to us. In accordance with its normal practice, the Department reserves the right to bring an enforcement action in the future if the actual operation of the proposed distribution company proves to be anticompetitive in any purpose or effect.

This statement is made in accordance with the Department's business review procedure, 28 C.F.R. § 50.6. Pursuant to its terms, your business review request and this letter will be made publicly available immediately, and any supporting data will be made publicly available within thirty days of the date of this letter, unless you request that any part of the material be withheld in accordance with Paragraph 10(c) of the business review procedure.

Sincerely,

/s/

Joel I. Klein
Assistant Attorney General

Enclosure