

UL

COVINGTON & BURLING

1201 PENNSYLVANIA AVENUE, N.W.

P. O. BOX 7566

WASHINGTON, D.C. 20044

(202) 662-6000

TELEFAX: (202) 662-6291

TELEX: 89-593 (COVLING WSH)

CABLE: COVLING

ACHESON HOUSE
46 HERTFORD STREET
LONDON W1Y7TF ENGLAND
TELEPHONE: 44-71-495-5655
TELEFAX: 44-71-495-3101

BRUSSELS CORRESPONDENT OFFICE
44 AVENUE DES ARTS
BRUSSELS 1040 BELGIUM
TELEPHONE 32-2-512-9890
TELEFAX: 32-2-502-1598

CHARLES F. (RICK) RULE

DIRECT DIAL NUMBER

(202) 662-5119

February 8, 1991

BY HAND

The Honorable James F. Rill
Assistant Attorney General
Room 3107
Antitrust Division
Department of Justice
Washington, D.C. 20530

Dear Mr. Rill,

On behalf of Affiliated Distributors ("AD"), I hereby request a statement of the current enforcement intentions of the Department of Justice with respect to the proposed joint bidding program described below.^{1/} This request is made pursuant to the procedure for the issuance of business review letters set forth in 28 C.F.R. § 50.6 (1990).

AD is a corporation that currently works with a number of independent local and regional distributors of electrical equipment (AD's "members" or "affiliates") to help them procure equipment from manufacturers (referred to as "vendors"). AD also helps its members promote the sale of these lines of equipment. AD currently is not involved in the resale negotiations between its members and their customers.

Under the proposed joint bidding program (referred to as the "National Contract Program" or "Program") for which AD is requesting a business review letter, AD will coordinate joint efforts by its members to bid for "national contracts" that require the delivery of specified electrical equipment on short notice to a number of locations across the country. Because AD's members have operations that are confined to one, or at most a few states, each member by itself typically is

^{1/} A detailed outline of the proposed program is attached at Appendix 1 for your reference.

The Honorable James F. Rill
February 8, 1991
Page 2

unable to compete effectively for such national accounts. By bringing together members with distribution facilities in the different geographic areas in which the national customer requires delivery, AD seeks to overcome the individual incapacities of its members and to create a new competitive distribution alternative that previously has not been available to national customers.

Affiliated Distributors and the Distribution of Electrical Equipment

AD is an organization of 171 electrical equipment wholesale distributing companies with 572 branches throughout the country.^{2/} The organization currently negotiates volume discounts with approximately 95 vendors of electrical equipment. By design, AD consists solely of local and regional distributors and does not accept applications for membership from any of the national electrical equipment distributors, which are described below.^{3/} The purpose of AD's current activities is to enable these smaller companies to compete effectively against the greater purchasing power and marketing resources enjoyed by national distributors. As a group, AD members account for \$3 billion in sales of electrical equipment, or about 8 percent of the \$39 billion in sales of electrical equipment made in the United States in 1989.^{4/}

The electrical equipment distribution industry is unconcentrated. There are four distributors, with locations across the country, that sell a full line of electrical equipment. Westinghouse Electric Supply Company ("WESCO"), a subsidiary of Westinghouse Electric Corporation, has 225 locations and accounts for about 2 to 3 percent of the sales

^{2/} A list of AD members and their branch locations is attached at Appendix 2.

^{3/} In addition, AD does not allow its members to affiliate themselves, either on a continuing basis or for discrete programs, with competing organizations of independent distributors.

^{4/} Estimates of electrical equipment sales by region, with the corresponding share for AD, are attached at Appendix 3.

The Honorable James F. Rill
February 8, 1991
Page 3

of electrical equipment in the United States.^{5/} General Electric Supply Company ("GESCO"), a subsidiary of General Electric Company, has 130 locations and also accounts for about 2 to 3 percent of United States sales. Graybar, an independent distributor with national scope, has 197 locations and about 4 to 6 percent of United States sales. Consolidated Electric Distributors ("CED") has 300 locations and accounts for about 4 percent of the market. In addition, All Phase Electric has 102 locations scattered throughout most, but not all, states and accounts for about 1 percent of total United States sales.

The remainder of the market for electrical equipment is accounted for by local and regional distributors that are similar to AD's members. There are several cooperatives of distributors in addition to AD. Some cooperatives are composed of distributors with locations that tend to be confined to particular regions of the country. For example, membership in Western Independent Electrical Distributors ("WIED") has been limited to western states, and The Independent Electrical Distributors, Inc. ("TIED") draws its members primarily from the East and South. There is at least one other cooperative, Interco, which is composed of plumbing and electrical equipment distributors, with locations throughout the nation. The cooperative other than AD with the largest volume of electrical equipment sales, TIED, accounts for only 4 to 6 percent of United States sales. To the best of our knowledge, none of the other cooperatives have established joint bidding programs such as that contemplated by AD.

National Contracts

Recently, a distinct market for "national" contracts has emerged. Some large purchasers, such as Exxon, have begun soliciting bids for contracts that require specified electrical equipment to be supplied to a number of locations across the country. In order to ensure prompt, reliable service and/or to take advantage of "just-in-time" delivery, such an end-user often will prefer to contract with a distributor having a warehouse close to each of the end-user's locations. Moreover, by procuring equipment for all its locations in a single contract, such an end-user can gain larger volume

^{5/} The market shares for these companies are general estimates made by personnel at AD.

The Honorable James F. Rill
February 8, 1991
Page 4

discounts and reduce administrative costs. AD estimates that 5 to 10 percent of the total electrical distribution sales in the United States are now channeled through these national contracts. In addition, the national contract market appears to be growing far more rapidly than the industry as a whole.

Only the largest electrical distributors, such as GESCO, WESCO, and Graybar, currently have the capacity to operate consistently at this national level.^{6/} While it is difficult to obtain precise figures, AD believes that these three companies account for the almost 50 percent of the distribution of electrical equipment that is sold pursuant to national contracts. Although larger regional distributors account for most of the remainder of the market for national contracts, their share of the market is shrinking as national accounts increasingly turn to the greater convenience that only those firms with locations nationwide can offer. AD's members on a few occasions have managed to come to terms with national accounts, but individual affiliates increasingly are finding that it is impossible to meet the delivery requirements specified in the bid solicitations of national end-users.

AD's National Contract Program

Because it is very often the case that none of its members can compete for these national contracts on their own, AD is proposing a joint bidding program.^{7/} As currently envisioned, individuals employed by AD (and not by any of the members) will administer the program. The AD members invited to participate in a particular bid will vary depending upon the specific requirements of the end-user soliciting bids. Although, as described below, AD employees will gather information from, among others, individual AD affiliates in order to assemble the most competitive bid, AD's staff will have **sole discretion** in determining the price and other terms to be bid to the end-user.^{8/}

^{6/} We do not know why CED has not yet entered the market for national contracts.

^{7/} See Appendix 1.

^{8/} In essence, AD will develop an individual bid price for each solicitation consisting of two components: the cost to
(footnote cont'd)

The Honorable James F. Rill
February 8, 1991
Page 5

Under the Program, AD first will determine the needs of the end-user, such as the required equipment and the maximum length of time allowed between order and delivery. AD next will negotiate with vendors to obtain the best price on the equipment to be supplied under the contract. AD also will gather information from vendors, AD members and others in order independently to determine the price that should be bid. During its preliminary discussions with members, AD may disclose, without revealing the source of any information, aggregated information concerning market conditions and details about previous contracts awarded by the end-user soliciting the bids.

After AD has formulated its bid to the end-user and shortly before the bid is due to be submitted, AD will approach each member capable of servicing any portion of the national contract and ask for the minimum gross operating margin that the member will accept given the expected volume of the contract.^{9/} The affiliate will not have access to AD's proposed bid at that point. If the information supplied by a member indicates that it cannot meet the terms that AD plans to bid -- for example, because the member's minimum acceptable margin exceeds the margin AD has factored into its intended bid -- then the member will be informed that it cannot participate and will be given no further information. If the member does qualify, then it will be given the opportunity to participate in the joint bid. Any member that is willing and able to participate will be required to execute a written agreement committing the member not to disclose any information concerning AD's bid to anyone, including other AD members, except the end-user or AD itself. After executing such an agreement, the member will then gain access to AD's bid. AD members to whom AD's bid is disclosed will be precluded from participating in competing bids in order to ensure the confidentiality of AD's bid.

Once AD has identified the members participating in the bid, it will submit its bid to the end-user along with a

(footnote cont'd)

AD's members of the equipment to be supplied (which will be equal to the price quoted by the vendor to AD) and the gross operating margin on each sale which will cover the distribution services provided by AD's members.

^{9/} AD also will have to verify that the member can meet any specific requirements of the contract, such as a 24-hour delivery time.

The Honorable James F. Rill
February 8, 1991
Page 6

list of the participating AD members. If the list includes more than one AD member for a given end-user location, the end-user will choose which of the AD members will service the contract. If AD's bid prevails and the contract is awarded to AD, the end-user will order the equipment covered by the contract directly from the closest participating member which in turn will invoice the end-user on the basis of the terms specified in the contract.

Although the Program as described above contemplates that, for each item of equipment specified in the bid invitation, AD will submit a single price to which all participating AD members will be bound, AD is willing to accommodate customers desiring a range of prices. It is AD's understanding that current bid solicitations for national contracts request that a single price be bid for particular equipment regardless of where it is to be delivered. If, however, a given end-user prefers a bid with a range of prices reflecting the lowest possible price at which the bidder is willing to deliver the equipment to each location, AD will attempt to accommodate such a request. The bidding process in such a circumstance will be virtually the same as above, but AD will determine the lowest price that its members can bid for each end-user location rather than the lowest uniform price at which the equipment can be supplied to all the specified locations. That is, if a member in one area is willing to supply the equipment at a lower margin than is the case for other members in other areas, AD will quote, at the customer's request, different prices reflecting the lowest margin offered by any of its members for delivery of the same equipment to each of the customer's different locations.

Participation in the joint bidding program will be completely voluntary. Members of AD will be required to elect whether to participate vel non in a joint bid approximately one week before submission of the bid to the customer. Unless and until a member elects to participate, signs the confidentiality agreement, and learns of the bid that AD intends to make, the member will be free to participate in a competing bid. A decision by a member not to participate in a given AD bid or to participate in a competing bid will not subject the member to any penalty and will not hinder the member's ability to participate in any subsequent AD bid. As a result, AD members will be free to choose to compete for a national contract either as part of AD's joint bid, with other groups,

The Honorable James F. Rill
February 8, 1991
Page 7

unilaterally, or not at all.^{10/} On the other hand, any member that has sufficient locations to meet all the requirements established in a particular bid solicitation will not be eligible to participate in AD's joint bid. This restriction ensures that AD's participation will serve only to increase, never decrease, the number of bids for national contracts.

The proposed AD joint bidding program is similar in many respects to the joint bidding arrangement of the Independent Drug Wholesalers Group ("IDWG") reviewed by the Division in 1987.^{11/} As was the case with IDWG, a separate entity, AD, which is distinct from the participating competitors will collect all the necessary competitive information and will provide the infrastructure necessary to enable its geographically constrained members to compete on a national scale.^{12/} Like IDWG, AD's Program will allow members to compete individually if they so choose and will prevent the exchange among competing members of competitively sensitive information collected by AD during the bidding process.

The proposed AD Program will contain additional safeguards beyond those accompanying the IDWG arrangement. In order to ensure that the Program focuses on "national contracts" for which its members generally are now unable to compete, the Program will be limited to contracts requiring delivery from local warehouses in 5 or more locations that are separated by 50 miles or more. Moreover, any member of AD

^{10/} An AD member's participation in a joint bid submitted by another group, of course, would have to be consistent with AD's general prohibition against a member's affiliation with competing cooperatives, such as TIED or WIED. This restriction will exist whether or not AD has its own joint bidding program.

^{11/} See Letter to Marc L. Fleischaker from Charles F. Rule (May 18, 1987).

^{12/} The use of a separate entity, AD, to gather sensitive information provides greater safeguards than did another joint bidding program to which the Division has granted a favorable business review. See Letter to Robert A. Lipstein from Charles F. Rule (April 22, 1985) (favorable review of U.S.D. Corporation joint bidding program). That joint bidding program, formed by U.S.D. Corporation, delegated the responsibility of gathering information to the distributor in the region containing the national customer's headquarters.

The Honorable James F. Rill
February 8, 1991
Page 8

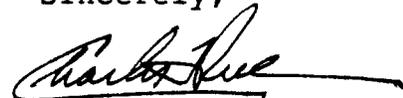
that has the capability of servicing a contract on its own will not be eligible to participate in the joint bid for that contract.

Conclusion

The AD Program is unambiguously procompetitive. It will create a new competitive alternative for national end-users in a national market that is currently dominated by three companies. Moreover, the Program is consistent with the precedents for favorable business review letters provided to joint bidding arrangements.^{13/}

Thank you for your consideration of this matter. If you have any questions or require any additional information, please let me know.

Sincerely,



Charles F. Rule

Attachments

^{13/} See Letter to Marc L. Fleischaker from Charles F. Rule (May 18, 1987) (reviewing IDWG joint bidding program); Letter to Robert A. Lipstein from Charles F. Rule (April 22, 1985) (favorable review of U.S.D. Corporation joint bidding program). Cf. Letter to F.M. Bush from Charles F. Rule (April 7, 1987) (favorable review of preferred provider organization ("PPO") for hospital services proposed by North Mississippi Health Services, Inc.); Letter to Robert Taylor from Charles F. Rule (October 3, 1986) (favorable review of PPO established by Pharmaceutical Care Network); Letter to Frank Sanchez from Charles F. Rule (October 3, 1986) (favorably reviewing another PPO).