

SHUMAKER, LOOP & KENDRICK, LLP

NORTH COURTHOUSE SQUARE
1000 JACKSON
TOLEDO, OHIO 43624-1573
TELEPHONE (419) 241-9000
FAX (419) 241-6894

TAMPA OFFICE
SUITE 2800 - BARNETT PLAZA
101 EAST KENNEDY BOULEVARD
TAMPA, FLORIDA 33602-5151
TELEPHONE (813) 229-7600
FAX (813) 229-1660

CHARLOTTE OFFICE
SUITE 2150
227 WEST TRADE STREET
CHARLOTTE, NORTH CAROLINA 28202-1675
TELEPHONE (704) 375-0057
FAX (704) 332-1197

WRITER'S DIRECT DIAL NUMBER:
(419) 321-1325

August 27, 1997

Joel I. Klein, Esquire
Assistant Attorney General
United States Department of Justice
Antitrust Division
10th & Pennsylvania Ave., N.W.
Washington, D.C. 20530

VIA FEDERAL EXPRESS

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PREMISES OFFICE
ANTITRUST DIVISION

Re: Depot Direct, Inc.
Our File No. 40669

Dear Mr. Klein:

The undersigned, on behalf of our client Depot Direct, Inc., does hereby submit this request for Business Review pursuant to the Antitrust Division's Business Review Procedure, 28 C.F.R. §50.6. We are available to provide any additional information that may be of assistance in evaluating this request.

Set forth immediately below is a description of the proposal for which we request a business review opinion.

Depot Direct, Inc. ("DD") is, in its conceptual form, an independent, for profit, enterprise established by investors to buy and resell industrial products to distributors, vendors and end-users of fluid power and motion control systems (hereinafter referred to as "the market"). It is the intention of the founders of DD to create a resource company that will acquire products directly from manufacturers, inventory such products and resell them to customers. It is expected that utilization of currently available communication technology, centralized purchasing, distribution and warehousing, consolidated transportation and consolidation of overhead expenses relating to inventory acquisition and management will produce substantial cost savings to participating manufacturers as well as to customers of DD. The operation of DD and the utilization of its services will allow manufacturers and customers to reduce costs by the creation of efficiencies; these cost savings should ultimately enure to the benefit of consumers.

Currently, these products are manufactured and sold

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within the market pursuant to a traditional paradigm whereby manufacturers sell products to authorized distributors who resell them to other vendors (described below) as well as directly to end-users. Distributor purchases are not centralized or pooled in any fashion and normally end-users are therefore required to deal with a wide variety of vendors for in-plant and mobile systems equipment. Because vendors are required to warehouse large inventories of products for "just-in-time" delivery, the cost of product acquisition, possession and distribution are high. Similarly, because manufacturers must deal with a number of distributors to whom they make individual shipments, transactional costs arising from individual marketing, invoicing, credit and shipment are significant. It is the hope of its founders that DD will serve as a central warehouse and distributor of these products, thus increasing efficiency for all and promoting better and faster delivery of products to the end-user. It is expected that utilization of DD will also create specific savings to its customers in the form of elimination of (1) risks associated with inventory maintenance (insurance, risk of loss, delay, obsolescence), (2) costs in the form of capital outlay for inventory acquisition, warehousing costs, personnel, etc., (3) transportation costs (in the case of drop shipments), (4) information handling, (5) purchasing and (6) service delay (including, for example, costs of postponement and lost opportunity costs).

Structurally, DD will initially consist of approximately 18 investors who will provide the start-up financing for the establishment of the company. The initial capital investment is expected to be approximately \$3,000,000 - \$3,500,000 to be followed by a subsequent IPO. Initial investors will consist of persons who own or have an interest in industry enterprises such as, for example, authorized distributors in the market as well as informed participants in the development of DD's operational model. Ultimately, however, investors will consist of a broad range of shareholders, including non-industry entities or persons. Initially, DD will focus its activity in the described market, however, once DD is operational, additional products may be added in response to market demand. Initial products handled by DD will fall into "CPG's" (contract product groupings) which shall include: hydraulic valves, hydraulic motors, hydraulic pumps, accumulators, flanges, electric motors, pneumatic valves, cylinders, electric controllers, power units, sensors and other allied products for in-plant machine applications and processes as well as mobile equipment applications.

If DD is successful to the maximum extent of its pre-

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operational strategic plan (which is probably unlikely), it will still represent an average of less than 10% of total U.S. purchases by product line. Attached hereto as Exhibit A is a breakdown of the U.S. market for the 21 separate product category groupings which DD plans to sell. Even assuming fully anticipated success, DD would not likely exceed a maximum of 18% of purchases in any single major product line, with its typical purchase share being approximately 8.3%.

As is also evident from Exhibit A, the manufacturing market for these products is not (with the exception of accumulators, which is a comparatively small product line) dominated by any one manufacturer with a market share in excess of 22%. Individual manufacturers in this market (e.g., Eaton Corp., Vickers, Rexroth, Dana Corp., Parker, etc.) also tend to be large, diverse, multi-national companies with the resources and ability to easily resist, defeat or by-pass any large buyer pressure that may be deemed to be undesirable. Similarly, the end-use buyers for these products include very large, multi-national manufacturers (such as, for example, General Motors Corporation, General Electric, Ford, Chrysler, etc.) that will always be able to buy product from the vendors of their choice.

For these reasons, it will not be possible, as a practical matter, for DD to disrupt established competitive protocols in either the manufacturer or end-user markets by causing increases in prices, reduction of supply alternatives, boycotts of manufacturers or any other anticompetitive effects.

It is anticipated that DD shall have its own independent, full-time management and a Board of Directors comprised of outside directors, management directors and investor directors. It is currently expected that investor directors will not comprise a majority of the Board.

From an operational standpoint, DD will operate as follows:

1. DD will purchase products from manufacturers at negotiated prices which hopefully will not exceed currently established prices for authorized distributors. All pricing negotiations with manufacturers will be conducted exclusively by representatives of DD who are not employed by (a) any customer of DD, or (b) any investor/distributor. Negotiations with manufacturers (including prices and terms and conditions of sale) will be kept confidential from all DD customers and industry investors at all times. Supplying manufacturers will be selected

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by DD representatives (without involvement of DD customers or members and industry investors) after inviting specific manufacturers to attend presentations as representatives of various commodity groups; competitive vendors will not be invited to attend the same meetings. Initially one manufacturer per commodity group will be selected, but other manufacturers may be added as needed in the future.

It is anticipated that, at least for a period of time, DD will pay certain refunds to its manufacturers on an annual basis. The refund to manufacturers is based upon DD's recognition that (a) manufacturers need an incentive to do business with DD and (b) the manufacturers who process products through DD will have created an actual demand for an alternative supply methodology in the marketplace which DD is filling. This commitment to use DD will obviously help DD. However, in order to market in this manner, manufacturers will have to make significant investments in education, sales, marketing, advertising, technical assistance, application support and investment in manufacturing capabilities, etc. Most manufacturers, in developing various channel strategies, have already invested significantly to gain a market presence and penetration level. The DD manufacturer's refund program acknowledges this past and future investment and attempts to remunerate the manufacturer for these efforts, in essence, DD views this refund program as a marketing expense as it is the manufacturers who promote DD's market access. Hopefully, if DD is successful, the manufacturers will experience additional financial returns that will facilitate future product development, sales function, marketing programs, application innovations, warranty responsibilities, and the customer support efforts retained by the manufacturers.

It is anticipated that refunds to manufacturers will be calculated on the basis of the annual, targeted volume of each manufacturer's products moved through DD to DD's customers. The refund program (which is dependent upon the profitability of DD) will be funded by gross profit margin dollars of DD. Attached hereto (for purposes of illustration) are Exhibit B (showing the market paradigm prior to DD) and Exhibit C (showing the anticipated operational assumptions of DD).

2. Customers of DD will fall into five general categories, discussed separately below. Each category represents the current vendors in the market:

- (a) Authorized Distributors. DD will sell to authorized distributors who have been selected

(previously) by manufacturers as authorized to resell their products, provide authorized warranty and service work, engage in product development efforts and general marketing and advertising activities. DD will have no voice in the selection or direction of authorized distributors and will have no involvement in their resale of products, which products they will sell to whomever and at whatever prices, terms, and conditions of sale they individually choose.

- (b) End-Use Customers. DD will sell to end-use customers (bypassing all other distribution levels) upon request. An end-use customer is a purchaser who buys for his own consumption or use.
- (c) Consolidators. DD will sell to "consolidators," who are entities that, at the request of end-use customers, handle all purchasing functions or relationships with the end-use customers' suppliers for a single commodity group or multiple commodity groups. The consolidator accumulates all invoices from the suppliers and provides one invoice to the end-use customer on a scheduled basis (usually monthly). Most manufacturers will sell only to authorized distributors. However, due to the large number of distributors who supply a vast variety of needed products to the end-user plants, the consolidator assists the plant by handling all of those purchases for the end-use customer. This is a basic outsourcing of a functional process normally handled by the end-use customer. Most consolidators receive their income not from a resale profit on the products themselves, but rather in the form of "cost plus" fees, fixed fees or transactional fees.
- (d) Integrators. DD will sell to "integrators" who are entities that, at the request of the end-user, may go on-premise at end-user plants in order to take over various functional processes such as the purchasing function, store room functions or receiving functions

for them. Often referred to today as "outsourcing," this concept (like the consolidator) saves end-users the cost of personnel and employee benefits while performing the purchasing function. As in the case of consolidators, integrators receive their income not from a resale profit on the products themselves, but in the form of fees paid by the end-user. Consolidators and integrators are part of the new concept of increased efficiency and reduced cost (to the end-user) in the order fulfillment process.

- (e) Resellers. DD will sell to "resellers" who purchase small volume items for resale to end-users. Resellers may be authorized distributors of other products. Resellers merely purchase non-authorized items in order to facilitate the supply process for the end-use customer. Resellers typically buy and resell specialty or emergency items in spot sales transactions and represent a very small amount of total sales in any product line.

3. All customers of DD who are willing to commit to a minimal, annual volume of purchases from DD and pay to DD an annual prepaid fee will be designated as "members." Depot Direct will charge a reduced fee to members because of their commitment to place a minimal volume through the DD process. Membership shall also be available to all customers on an equal basis. Members will also receive a bonus at the end of the year if DD is profitable that year, based upon an equal and proportionate formula. Non-member customers who make no volume commitment to DD, are not at risk financially but can utilize the services of DD at will as frequently or infrequently as they wish. Because of this lack of risk (or commitment), the non-member will typically pay a higher fee and will not receive a year-end bonus. Members may or may not be investors. Investors will also receive dividends to the extent appropriate.

4. DD will not violate the Robinson-Patman Amendment to the Clayton Act in any manner.

5. DD will sell products to all categories of customers regardless of whether they are members or non-members. Because DD's initial investors and Board members include companies that are currently distributors of many of the products to be handled by DD,

the selection and pricing of products resold to customers (for some of whom distributor investors may compete) shall be exclusively determined by DD management personnel. To the extent that pricing issues need to be considered at the Board of Directors level, only members of the Board who are not distributors or customers for such products shall be involved. Prices, terms or conditions of sale, volumes and types of products for individual customers will not be shared with, discussed or disclosed to any other customer, investor, competitor or supplier of any customer at any time.

6. All member and non-member distributors will pay fees to DD based upon their proportionate volume of purchases and their commitment to utilize DD services as witnessed by their yearly prepaid fee. The formula for determining fees will be uniform and available to all customers, the % of fee decreasing with the increases in the volume of purchases. All fee levels will be functionally available to all customers of DD. The fees collected will offset the operational costs of DD, provide a profit to its investors and fund refunds to manufacturers.

7. All customers, including members of DD, shall be free at all times to purchase products from any other available source, including directly from the manufacturer, or from another distributor, including another member distributor.

8. All communications between DD and individual member and non-member customers of DD as to that person's purchasing practices (amounts, type of product, terms, price, etc.) will be kept confidential and not disclosed to members or investors.

9. DD will not become involved with (or discuss with its customers) the resale decisions of its customers. This includes resale prices, markets to be sold, product mix, etc.

10. In order to protect confidentiality, all DD professional staff will follow written employment policies which forbid them from providing restricted information (as set forth above) and indemnify them from the consequences of resisting pressure to do so.

DD is not likely to create any monopsony issues since its focus is not upon maximum volume discounts, but rather upon achieving efficiencies that will reward DD customers and manufacturers in the form of cost savings, and investors in the form of profits from fees paid in consideration of such cost savings. At each level of distribution, cost savings are expected to exceed the fees charged by DD to its customers. If this proves

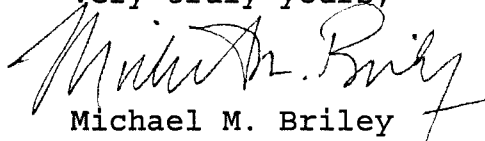
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not to be the case, since no one is required to buy from DD, its customers will shift their purchasing back to traditional distribution channels. Similarly, if manufacturers do not experience or perceive cost savings flowing from the sale of products through the DD system, they will forego such sales and continue direct sales to authorized distributors or directly to end-users (e.g., national accounts sales). Since all DD purchasing decisions, sales decisions (prices, terms of sale and products), vendor selection and product selection will be handled on a confidential basis by DD staff, there will not exist any opportunity for price collusion (horizontally or vertically) or group boycott issues. Finally, since DD will represent an average of less than 10% more of national purchases in the market, it will not be able to exert sufficient market leverage over any manufacturers to disrupt the normal competitive environment of any product market.

With the support of manufacturers, distributors, suppliers and end-users, and the showing of expected efficiencies and commitment savings flowing from the operation of DD, this proposed concept will create a procompetitive effect in the marketplace.

As stated above, we would be happy to provide any additional information required upon request. Thanking you for your consideration of this matter, I am,

Very truly yours,



Michael M. Briley
Legal Counsel to
Depot Direct, Inc.

MMB:mmb

cc: Barry Grossman, Esquire

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