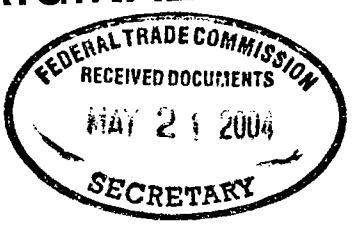
Comment #: 1

VWG
Victory Wholesale Grocers

ORIGINAL



May 20, 2004

ADDENDUM C TO THESE COMMENTS IS DESIGNATED CONFIDENTIAL COMMERCIAL INFORMATION UNDER 16 CFR § 4.10

Donald S. Clark
Secretary
Federal Trade Commission
Office of the Secretary
Room 159-H, Annex G
600 Pennsylvania Avenue
Washington, D.C. 20580

RE: RFID Workshop – Comment, P049106

Dear Mr. Clark:

Victory Wholesale Grocers ("Victory") appreciates the opportunity to submit these comments to the Federal Trade Commission in connection with the "RFID Workshop." We will address several issues; including the privacy concerns to small privately owned businesses. Another issue deals with anti-competitive and anti-privacy concerns that arise out of the RFID technical standards. RFID standards have been created and developed by large manufacturers and power buyer retailers with the aim to assist them in furthering their businesses[1]. Wholesale distributors, small retailers and consuming public have been left out of the standards setting equation and, as the FTC will discover in its RFID workshop, their interests have been vastly ignored. Lastly, and most importantly, we will explore the impact RFID will have on the marketplace. Specifically, how consumers can be harmed by the technology if appropriate safeguards are not built into the RFID infrastructure.

The FTC should also review the infrastructure and cost to implement RFID, specifically these costs, to quote Kroger Company, "would be astronomical."[2] Some of these costs will be passed through the system and ultimately paid by

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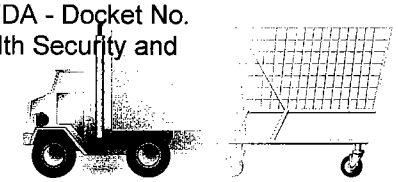
[1] See Appendix A for a list of founding participants in the Auto-ID Center.

[2] July 8, 2003 submission by Kroger to U.S. Food and Drug Administration (FDA - Docket No. 02N-0277 – Establishment and Maintenance of Records under the Public Health Security and Bioterrorism Preparedness and Response Act of 2002 (the "Bioterrorism Act").

CONFIDENTIAL



the consumer in the form of higher prices without any commensurable benefit to the consumer[3].

I. Who is Victory Wholesale Grocers and what is its business

Victory is a privately family owned promotional wholesaler of dry grocery, health and beauty care (HBC), pharmaceutical, general merchandise and other consumer goods. A promotional wholesaler is one engaged primarily in a "wholesaler to wholesaler" business. That is to say that Victory purchases products in the open market from legitimate suppliers such as other wholesalers and stocking retailers (rather than directly from the manufacturer) and then resells the products to customers who need them. In short, Victory re-distributes products from sellers who have an excess or over-supply to buyers who have a short supply. In many ways Victory is an arbitrageur.

Victory's business is national in scope and its customers include the country's largest wholesale and retail grocery, drug, and mass merchandise chains. Its customers have come to depend on Victory for a variety of quality products and services, and for the competitive prices and related benefits that Victory's presence in the market provides. Victory sells genuine, first quality products at discount prices.

- Victory is family owned
- Victory has been in business over 25 years
- Victory is a small business
- Victory closely guards its commercial information

[3] Indeed as Kroger, Grocery Manufacturers of America, Kraft Foods and others in their comments to the FDA regarding proposed recordkeeping rules (Docket No. 02N-0277 of the Bioterrorism Act), have stated, lot code tracking through the food distribution chain (from the manufacturer to the retail shelf) is impossible and unnecessary. In a Class I recall; one involving a threat of serious adverse health consequences or death, public warnings are required to protect consumers who posses the products in their homes. "...examining records occurs as part of the in-depth investigation which takes place after consumers have been warned about the potential harm associated with a product and have stopped using it. Tracing the movement of ingredients and products becomes relevant as investigators seek the "root" cause of the situation and gather the evidence needed to place blame, punish offenders, and prevent reoccurrence, but is of limited value in directly protecting consumers during a national emergency." June 9, 2003 submission by Kraft Foods FDA - Docket No. 02N-0277 of the Bioterrorism Act.

II. Manufacturers are Victory's competitors

Manufacturers often refer to Victory's business as that of a "diverter." This label is pejorative and connotes something improper or even illegal, when in fact the product diversion (i.e. resale) business is a legitimate one[4]. Victory and other resellers are fully licensed and routinely inspected by applicable Federal and State authorities, such as the FDA, USDA, Department of Health, DEA, EPA, etc...that regulates and inspects food distributors.

Manufacturers try to portray diverters in negative terms because diverters compete directly with manufacturers and this competition tends to reduce the prices manufacturers can charge in the marketplace (intra-brand competition). Consumers are the ultimate beneficiaries of product diversion/reselling. Product diversion/reselling has become a normal part of American commerce. It is often referred to as the secondary market for goods. Each year billions of dollars of goods are purchased and sold through the secondary market. They include virtually any item one sees in discount stores, from groceries, HBC, drugs, clothing, electronics, watches, to general merchandise. The reduction or elimination of product diversion would have a devastating effect on these stores and the many millions of individuals and businesses who have come to depend on them as a source of quality products at discount prices.

Victory's presence in the marketplace increases competition, improves overall market efficiency and uniformity, and benefits retailers and consumers through access to lower priced goods. Victory and similar wholesalers help ensure a steady stream of product at optimum prices both to grocery and drugstore retailers, as well as to the ultimate consumer. The fact that numerous or all reputable grocery and drug chains elect to deal with Victory and similar wholesalers verifies the useful and proper role that such wholesalers play in the market. Victory's method of handling products does not compromise in any way the quality or appearance of the retail products it buys or sells. To do so would mean ruin for the distributor who needs to retain the confidence and satisfaction

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[4] Is Diversion Legal? Generally, in the absence of a lawful contractual obligation to the contrary (e.g. a sampling program where there is an express provision stating that the product is sold as a discount only for distribution as part of such a program) resale of goods is not illegal. Indeed, conditioning the sale of goods upon receipt of certification by the buyer that it will not resell could implicate Section 1 of the Sherman Act which prohibits restraints of trade which are the product of "contract, combination ... or conspiracy" and which are unreasonably restrictive of competitive conditions." See Appendix D, Dennis Donelon & Mark McGowan, Pepsi/Quaker, presentation at GMA IS/LD Conference, March 23, 2004.

of its customer. Courts have consistently rejected broad legal challenges to the activities of so-called "diverters", and at least one judge, upon being informed as to the activities of diverters, replied that it sounded like traditional capitalism.

III. How do Product Diversion Opportunities Arise

A diverter's business is built on the pricing policies of manufacturers. By offering multi-level pricing (i.e. manufacturers offer different prices, incentives and/or terms to different regions, classes of trade and/or customers), manufacturers make product diversion/resale possible.

There are generally two types of such resales. The first is sometimes referred to as "geographic" diversion. In this case, manufacturers offer identical products at different prices in different regions of this country or in different regions of the world. When these pricing differences exist, a diverting company will buy product from the region where prices are lower and resell it in a region where the manufacturer's prices are higher ("geographic arbitrage"). The second type of product diversion is sometimes referred to as "time diversion" or "forward buying". In this situation, purchasing opportunities exist when a manufacturer provides a promotion that is limited in time such as a seasonal promotion or announces a future price increase. In a forward buy diversion, a diverting company will acquire products during the promotional period, or, in the case of seasonal merchandise, at the end of the season, and will resell the product either when the price returns to its usual level or in a region (or season) where the seasonal goods are in demand or after the price increase has been implemented ("time arbitrage").

IV. Why Product Diversion Thrives - Manufacturer Pricing Programs – How Consumers Benefit From Diversion

Most manufacturers want to find a way to charge each customer the highest price they are willing to pay. Economists predict that in a perfect price discrimination model where the maximum price is charged to each customer willing to pay the price, the concern can earn approximately double the profit that they could realize by charging a single price to all customers. (Bruce Hamilton, Professor of Economics, Johns Hopkins University, in a October 2000 report captioned "Impact if New PDMA Rules on the Pharmaceutical Distributor

Markets" submitted to the FDA (the "Report"[5]). Price discrimination opens the door for arbitrageurs, such as Victory.

"The economic role of the arbitrageur, though not the role envisioned by the arbitrageur himself, is to enforce the law of one price. The law of one price states that in a freely functioning market, in which there are no artificial impediments to arbitrage, any given commodity must command only one price throughout the marketplace." The Report at page 3.

Accruals, promotional allowances, incentives, trade terms and rebates are some of the many methods used by manufacturers to customize the price paid by its customers, the retailer. In essence the practice allows a manufacturer the ability to charge its customer at or near its list price and apply a more selective form of discount by giving its customer, the retailer, an accrual, promotional allowance, rebate or other promotional program to disguise the real discount and allow the manufacturer to maximize the price it charges to each customer thereby maximizing its profits.

Victory and other promotional wholesalers purchase and sell on price alone, "everyday low price" to quote Wal-Mart, and to buy at the best price the distributing wholesaler/retailer must calculate the amount of the accrual, promotional allowance, incentive and/or rebate and reduce that from the manufacturer's quoted "list price" to determinate whether the net price offer by the manufacturer is at or below the price offered by Victory. In order to be competitive, Victory must generally be able to sell its product lower than the manufacturer's unbundled price. This in turn puts more price pressure on the manufacturer to lower its price or lose an order, which is why manufacturers' despise diverters wanting nothing short of their elimination.

V. Manufacturers Opposition to Diverting

As evidenced by the attached anti-diversion materials[6], it is obvious that manufacturers of diverted products look upon companies such as Victory with considerable disdain and wrongly view them as criminal entities that should be investigated, infiltrated and driven out of business (manufacturers often portray diverting companies as being connected with organized crime or the products

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[5] See Appendix B.

[6] See Appendix C and D.

themselves as being stolen, substandard or counterfeit to scare a party from dealing with a diverter). Thus it is little wonder that Victory and other promotional wholesalers should regard its essential business operations and relationships as confidential, and seek to shield them not only from its bitter business competitors and rivals, but also from the handmaidens of such competitors such as private investigator Michael Kessler and lawyers Rodney Brown and Donald deKieffer who tout their services to manufacturers of discovering and helping extirpate diverters[7]. Indeed one of the services offered by the parties include databases that contain information about diverters and their practices. They sell subscriptions to these databases and many of the nations largest consumer product manufacturers subscribe to these databases and engage the services of these "anti-diversion specialists". RFID data will be like a treasure trove to these databases, providing those subscribing with real time data on the movement of goods through commerce. This data will assist the manufacturer in eliminating diversion. Since many of these "anti-diverting specialists" are attorneys, the retaliatory actions are cloaked under attorney client privilege that makes proof of retaliation very difficult. One must not forget that the diversion opportunity exists, and is the sole creation of the vary manufacturers that want to stomp it out, because of their desire to charge their customers different prices for identical goods (i.e. maximize their profits).

VI. RFID Technology Allows Manufacturers to Control Post Sale Distribution/Pricing and Profits Outside *Colgate* Programs

Victory believes that RFID technology, if properly used, can be a great boon to the American economy and to American consumers. RFID technology can be a tool to aid product recalls. RFID technology can help to prevent counterfeiting and theft of product. Further, it can assist manufacturers, wholesalers and retailers in managing inventory.

Notwithstanding these undeniable benefits, Victory has several concerns about RFID technology that may not be well understood or covered by other comments.

First, Victory is concerned that RFID technology can be used by manufacturers to punish downstream sellers (both wholesalers and retailers) who sell products outside traditional distribution channels. Victory believes that such use of RFID

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[7] See PepsiCo/Quaker anti-diversion materials and Kessler and deKieffer web site information, Appendix E and F.

technology will harm consumers by depriving them of lower prices that are often available precisely because wholesalers and retailers routinely buy and sell outside the traditional distribution chain.

It is no secret that manufacturers have long sought to eliminate promotional wholesalers like Victory. The reasons why manufacturers seek to eliminate promotional wholesalers vary. In some cases, like professional hair care products, the manufacturers desire to tightly control retail prices. Such manufacturers terminate business relationships with salons that refuse to follow "suggested" resale prices. These manufacturers also terminate relationships with wholesalers who sell outside traditional channels. When the manufacturer attempts to derive excessive profits for itself and its favored resellers through this closed system, opportunities arise to divert product. This rigid imposition of "suggested" resale prices is disrupted when a retailer or wholesaler sells to a promotional wholesaler, who, in turn, sells to a retailer (drug store or supermarket chain) who is willing to sell hair care products far below the suggested retail price established by the manufacturer. In short, promotional wholesalers upset the manufacturers' resale price maintenance schemes[8]. In other cases (for example food manufacturers), the manufacturer may have developed a dizzying array of prices for customers in various (often arbitrary) categories and in various geographic locations. Promotional wholesalers assure that the lowest priced products reach retailers (and their customers) who otherwise would be disfavored under these promotional and pricing programs.

Some manufacturers object to product diversion notwithstanding the fact that this practice results in more sales of their products and the related profits associated with those sales. These manufacturers often will claim that product diversion encourages "free riding" or that product diversion creates health and safety issues or "customer confusion." The "free riding" arguments are vastly overblown. In reality, most consumer products require little, if any "point of sale" information or assistance. Courts have consistently rejected "free rider" arguments used to buttress trademark infringement claims involving consumer products. Similarly, courts have rejected dubious "customer confusion" and health and safety arguments put forward by manufacturers to support trademark infringement claims. Indeed the many comments submitted by manufacturers to the FDA in response to proposed recordkeeping rules under the Bioterrorism Act clearly indicate that the health and safety argument is a pretext ... "...examining

[8] It should be noted that if a manufacturer would sell the same good at the same price to all customers, the arbitrage opportunity would not exist and the good would not be diverted.

records occurs as part of the in-depth investigation which takes place after consumers have been warned about the potential harm associated with a product and have stopped using it. Tracing the movement of ingredients and products becomes relevant as investigators seek the "root" cause of the situation and gather the evidence needed to place blame, punish offenders, and prevent reoccurrence, but is of limited value in directly protecting consumers during a national emergency." June 9, 2003 submission by Kraft Foods FDA - Docket No. 02N-0277 of the Bioterrorism Act.

We believe that those manufacturers who object to product diversion do so because the intra-brand competition that arises as a result of product diversion adversely affects the manufacturer's profits. Product diversion can undermine a manufacturer's ability to enhance its profits by price discriminating between geographic regions and customers. Also, when a traditional retailer is faced with low price competition from a retailer who purchased the manufacturer's product from a product arbitrageur, the traditional retailer may demand lower prices from the manufacturer.[9] For example, the Beauty and Barber Supply Institute, Inc ("BBSI") has devoted substantial sums to "stamp-out" product diversion because the BBSI members do not like the price competition caused by this practice. An article concerning efforts by BBSI and others to obtain federal legislation that would have made it illegal to remove or tamper with so-called "product identification codes"[10] stated, "There is much more than lofty ideals at stake - - like money. Estimates vary widely as to how much product diversion to the mass industry costs the professional (hair care) industry" (or saves consumers) "each

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[9] In *John Paul Mitchell Systems v. Quality King Distributors, Inc.*, 106 F. Supp.2d 462, 475 (S.D.N.Y. 2000), the court aptly described the competitive effects caused by the diversion of premium hair care products. The plaintiff sold its hair care products only through designated hair salons. As a result of product diversion, the plaintiff's products became available to consumers at lower prices through other retail outlets. The court noted, "The salon owners stopped selling Paul Mitchell products only because the product appeared in retail outlets. They could no longer guarantee *a local monopoly* on sales of the product, and switched to products for which they would be one of the only sellers in a locality." Emphasis added. In reality, the more typical response of the manufacturer's designated retailers is to demand lower prices from the manufacturer so that they can compete with the "unapproved" retailers and continue to earn significant profits.

[10] The "product identification codes" that would have been protected with intellectual property type protections under the legislation supported by BBSI were not batch or lot codes that might be important in case of a product recall. Rather, they were product-tracking codes that would permit the manufacturer to determine the origin of diverted products, thereby giving them the ability to punish the violating concern.

year. However, it probably tops $100 million, according to estimates from the BBSI."[11]

VII. RFID Technology Can Be Used To Misappropriate Confidential Commercial Information From Competitors

Consumer products are currently identified by machine-readable bar codes known as the UPC or Universal Product Code, a creation of the non-profit Uniform Code Council. The UPC was originally created to speed up supermarket checkouts and to enhance inventory control. The information contained in a UPC code is extremely limited. A typical consumer UPC code is 12 digits; the first 6 digits identify the manufacturer and the last 6 digits identify the item. In order to read a UPC, the bar code must be visible to the scanner. A UPC bar code only tracks a product by brand and make, and cannot distinguish between two like items from different suppliers.

By contrast, RFID tags emit radio signals that are picked up by receivers, and can be read remotely via radio signal thus eliminating the need to have line-of-sight scanning of each individual units bar code. Each individual consumer good, case and/or pallet contain unique electronic product codes (EPC) which are essentially individual serial numbers associated with the item containing the RFID tag. EPCs are initially set up with the ability to store 96 bits of information. Manufacturers initially create and control the data contained in the 96-bit RFID tag and EPC. The information programmed into the tag can be tracked from the manufacturer of the product to the wholesale distributor to the retailer to the consumer and even to the waste or disposal facility. The EPC may be passive or active[12]. Unlike a UPC bar code, an EPC can distinguish like products from different suppliers, thus making it easy for a manufacturer to carefully control intra-brand competition imposed by discounters.

Victory is concerned that RFID technology can be used by business competitors to ascertain information about their competitors business such as its suppliers and customers, inventory and movement histories; this information is generally

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[11] September 10, 1999 article by Julie Naughton captioned "Bill Splits Hair Industry."

[12] An active tag contains a power source that powers the memory, radio and circuitry so that the tag can record things such as movement and storage conditions of goods. A passive tag are powered by the reader. Assuming readers were stationed throughout the US (like cellular phone towers), passive tag could also record movement and handling conditions of products.

treated as sensitive confidential commercial information to that concern[13] and protected under federal and state law (see discussion below).

To believe that RFID technology will be used internally merely as an inventory management tool is naive. If this were the case the RFID EPC would not need 96 bits of data and the creators of the system would not have any reservations about building into the technology infrastructure security measures that assure confidentiality to business and consumers. Each unit containing an EPC will have a unique serial number or identifier. The EPC can be read at any number of locations, entered into a database or databases and used to identify purchase and sale activity of businesses as well as individuals. The proponents of RFID give lip service to claims that they are interested in consumer (and business) privacy. After all these are giant marketing companies like Procter and Gamble and Gillette, companies that are leaders in the product categories they participate in and are ferocious competitors. For example, Gillette who reportedly controls 70% of the refillable razor business[14] filed suit against Schick hours after it announced its new four-blade razor to enjoin it from reaching the market. It is no surprise that Gillette, along with other major consumer product manufacturers, is a principal founder of the Auto ID Center, developer of RFID. Assuming that Gillette's interest in RFID is primarily related to reduction of shrinkage (theft), their goal could be easily attained without exposing business and consumer information to Gillette. Instead the RFID model says give Gillette all of the business and consumer information and they will be responsible to use the competitive business and consumer information only to reduce theft or inventory control safeguarding it from misuse by any other purpose. In other words consumers should trust the fox guarding the hen house. Why not change the RFID model to provide commercial and consumer information only as it relates to specific health and safety (Class I recalls) needs and law enforcement (such as to detect and punish counterfeiters and thieves) and not for any other purpose. Further the information should be provided only to law enforcement and the FDA or USDA in connection with a recall or other investigation, and the data should be

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[13] As Jack Welch, former Chairman and CEO of General Electric stated ... "a cardinal rule of business: Never allow anyone to get between you and your customers or your suppliers. Those relationships take to long to develop and are too valuable to lose." Jack Welch, *Jack Straight From The Gut*, Warner Books, 2001. Page 348.

[14] Theresa Howard, USA Today, Courtroom razor battle has Gillette, Schick in lather, posted October 13, 2003, USATODAY.com.

specifically restricted from disclosure to those having a commercial interest in deterring competition.

According to documents published by the Auto ID Center[15], the founder of RFID and the standard setting entity, one of the stated objectives that RFID technology was to address was the elimination of product diversion. For example, RFID permits manufacturers to "identify sources of diversion[16]" and "Company representatives, or law-enforcement, will be able to use hand-held devices to quickly verify the origins of products and establish their point of diversion.[17]" "The Auto-ID Center's vision is of a world where computers will be able to identify any object, anywhere, instantly. [18]" "... in turn enable those computers to track and trace the objects, triggering events, and even perform actions on the objects themselves.[19]" "... The mission of the Auto-ID Center is to ... help in the development and deployment of infrastructure to create a universal, open network for identifying individual products and tracing them as they flow through the global supply chain.[20]" "... with the potential to make companies vastly more efficient and profitable.[21]" In connection with these proceedings, the FTC should do a document search of the Auto-ID Center and EPCglobal Networks and review the standard setting process and design considerations into the RFID technology from a competition and privacy standpoint.

Retailers view RFID as a technology that will improve its inventory management, reduce theft and reduce its labor costs and improve the accuracy and timeliness of orders and sales. Retailers presently possess (or easily could do so with consumer loyalty cards or house charge accounts) information about the

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[15] The Auto-ID Center was recently merged with EPCglobal Network, an affiliate of the Uniform Code Counsel, another standard setting organization.

[16] Auto-ID Center, Radio Frequency and Auto-ID, 2001 slide presentation by Kevin Ashton, Executive Director, Massachusetts Institute of Technology presented at NACS: TECH 2001.

[17] Keith Alexander, IBM Business Consulting Services, Applying Auto-ID to Reduce Losses Associated with Shrink, November 1, 2002.

[18] Datasheet, The Auto-ID Center, An open initiative supported by Sun Microsystems, sun.com/software.

[19] Id.

[20] Id.

[21] Id.

purchasing habits of their customers, so RFID adds little to benefit retailer in this regard. These goals can easily be achieved without making their information available to any third party.

Manufacturers want to maximize sales and profits and can achieve their goals best if they can directly control the consumer and/or the movement of their goods to the consumer. RFID fills a large information gap to manufacturers. As technology evolves[22], which it surely will since RFID is in its infancy, a person could for example simply drive down a street and in a matter of seconds with a hand held reader, learn about all products in a consumers home or auto, including when they purchased them, where they purchased them, how much they paid and how they paid for the goods and directly market to these consumers on a customized price/product basis. Indeed permanent RFID data collection sites could be established by manufacturers, marketers and identity thieves to capture business and consumer data.

Clearly the creators of RFID are engineering the technology so that one of its functions is to vest control of competition solely in the RFID charter members, the world's largest consumer products manufacturers. The technology upsets and often disregards long established trade practices, laws and customs, including, without limitation, free trade agreements, treaties, first sale, exhaustion, intellectual property rights, privacy, trade secrets, antitrust and unfair competition laws and practices. They hide behind words like "health and safety" and "counterfeit" and "theft deterrent" to disguise their real agenda.

All of the laudable goals of RFID, such as improving order accuracy, order picking and fulfillment accuracy, locating product in warehouse and store shelves, verifying shipment and receipts of goods, improving inventory tracking and replenishment, authenticating genuine goods (identifying counterfeiting and product tampering), reducing labor costs for the manual tasks that may be replaced with RFID, and theft deterrence, can be achieved with RFID technology without the wholesale abuse and possible misuse of a business' commercial

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[22] Note in 1965, Gordon Moore, co-founder of Intel, predicted that the number of transistors per square inch on an integrated circuit doubled every year since the integrated circuit was invented and this behavior would continue into the future (known as "Moore's Law). This law has applied to computers, electronics and the related technologies. There is no reason to believe that Moore's Law won't apply to RFID technology, suggesting that in the next 5 – 10 years a RFID chip could contain 1,000 bits of data and be readable from a distance of a mile or more (such as by satellites).

information and infringement of consumers privacy. Business and consumer information should be protected and safeguarded so that no use may be made of such information (aside from legitimate law enforcement use) without the prior written consent of the owner.

RFID data should be available to law enforcement on a limited need to know basis such as tracing the origins and movement of counterfeit, tampered, adultered or stolen goods. Clear controls should be established like probable cause before access is granted to this information.

VII. How does RFID Impact the Marketplace?

As indicated above, RFID technology can permit manufacturers to determine how products have been diverted from the manufacturer's traditional chain of distribution. As the technology evolves, a manufacturer's agent can simply walk down the aisles of a drug store or supermarket and ascertain precisely where a particular unit of product came from. For example, if a hair care product manufacturer scans products in a "discount" drug store and determines that one of its products came from a particular "authorized" wholesaler or retailer, that wholesaler or retailer will be quickly disciplined[23]. As RFID technology advances, manufacturers could learn Victory's supply sources simply by driving past a Victory warehouse, or an individual's vehicle or house with an RFID scanner. They would immediately know what the business or individual purchased, from whom the goods were purchased and who handled them in the supply chain. The ability of manufacturers to use RFID technology as a tool to prevent goods from moving from locations where the manufacturer charges less to locations where the manufacturer charges more could have significant implications, for

[23] One of the principal methods used by manufacturers to stop product diversion is to claim that a retailer's sale of a diverted product infringes the manufacturer's trademarks or copyrights, notwithstanding the fact that the product in question is being sold in the manufacturer's original package without any change whatsoever to the product or the package. Most courts have correctly concluded that these claims are precluded by the "first sale" or "exhaustion" doctrines and have summarily dismissed the claims. Nevertheless, manufacturers have continued to file these baseless trademark and copyright claims knowing that the burden of litigation will cause some retailers to stop purchasing merchandise from promotional wholesalers. Manufacturers resort to litigation alleging trademark infringement, tortuous interference and unfair competition claims to try to stop retailers from selling diverted product because they lack the ability to directly threaten the "unapproved" retailers by cutting off supply, the principal way that manufacturers stop their designated wholesalers and retailers from selling product to promotional wholesalers. *See, Matrix Essential, Inc. v. Cosmetic Gallery, Inc.*, 870 F. Supp. 1237, 1242 (D.N.J. 1994), *aff'd*, 85 F. 3d 612 (3rd Cir. 1996).

example, on the movement of pharmaceuticals from country to country, an issue that is currently under review in Congress and commonly (and legally) practiced in the European Union. It is easy to foresee how pharmaceutical manufacturers could use RFID technology to impose distribution discipline to the detriment of American consumers.

Obviously, the biggest loser in this scheme is the American consumer who will be forced to pay for this new unproven and problematic technology in the form of higher prices. The commensurable benefit to the consumer is negligible, it may enhance product recalls (but won't eliminate the need to publicly warn the public of harmful product and to stop using it); it may eliminate counterfeit goods (however, though not legal, one could argue that a purchaser of counterfeit high-value goods such as watches and designer purses and clothing is aware that the goods they are purchasing are counterfeit based on the unusually low price and the manner in which those goods are sold, but choose to purchase them regardless. Thus there is no consumer confusion); and reduced theft, which may result in a retailer lowering the price of goods since the price includes the cost of shrinkage (although there is no evidence that these savings would be passed through to the consumer).

On the second point, the identity of Victory's supply sources and customers is proprietary information that is critical to Victory's success. RFID technology could allow Victory's competitors to determine where Victory is obtaining its supplies. Additional tracing could also allow Victory's competitors to ascertain Victory's customers.

In establishing guidelines for RFID technology, it is important that the preceding issues be considered at the outset. Once the RFID protocols are established, it will be very difficult to change.

VIII. Examples of Protectable Information and Rules that Protect such Information

The following are some examples of the type of information protectable and the laws that may protect them:

The Ohio Uniform Trade Secrets Act (O.R.C. §§1333.61 – 1333.69) includes as trade secrets "any business information or plans, financial information, or listing of names, addresses, or telephone numbers ... O.R.C. §1333.61(D). The trade secret definition can and does cover potentially broad range of business

information. *Vanguard Transportation Systems Inc. v. Edwards Transfer & Storage Co.*, 109 Ohio App. 3d 786, 673 N.E.2d 182 (1986) (customer lists; freight rates; freight driver lists); *Valco Cincinnati v. N & D Machining Service*, 24 Ohio St. 3d 41, 44, 492 N.E.2d 814 (1986) (acknowledging Restatement rule extending trade secret protection to "sale of goods or other operations of business," including pricing, discounts and the like; customer lists); *CPG Products Corp. v. Mego Corp.*, 502 F. Supp. 42 (S.D.N.Y. 1980) (cost and source of equipment information protectable); *WR Grace & Co. v. Hagadine*, 392 F.2d 9, 15-16 (6th Cir. 1968) (customer information and lists protectable despite the fact that the public may learn of operations, etc. as a result normal business operations); *Chem-Trend, Inc. v. McCarthy*, 780 F. Supp. 458, 461 (E.D. Mich. 1991) (information regarding customer needs and pricing strategy and quotes); *Pyromatics, Inc. v. Petruziello*, 7 Ohio App. 3d 131, 454 N.E.2d 588 (1983) (operating costs, prices and production details).

Federal Rules of Civil Procedure 45(c) (and 26(c)(7)) extends protection to a "trade secret or other confidential research, development, or commercial information ..." Weinstein argues that trade secrets should have a "broad definition that includes all business data that gives a better competitive position and whose value is substantially enhanced by secrecy." Federal Evidence (2d Ed.) 2§ 508.04[1]. Wright and Miller likewise make clear that the protection of the rule extends beyond "true" trade secrets. 8 Wright and Miller, Federal Practice and Procedure supra, § 2043 at nn. 4-7 (an interpretation that the authors favor). "The subject matter of confidential business information is broad, including a variety of business information." Miles v. Boeing Co., 154 F.R.D. 112, 114 (E.D. Pa. 1996) "Competitive disadvantage is a type of harm cognizable under Rule 26." Miles supra at 114.

In addition, in civil litigation, where a party seeks discovery of confidential business information, the burden is on the requesting party to demonstrate that the information in question is sufficiently relevant and necessary to his case to outweigh the harm of disclosure. Wright and Miller supra § 2043 at n. 11-13. (emphasis added) Courts often use *in camera* inspections to determine whether confidential information passes this enhanced relevance test. Id. At n. 11.

Rule 45 Federal Rules of Civil Procedure mandates that "a party or an attorney responsible for the issuance and service of a subpoena shall take reasonable steps to avoid imposing undue burden or expense on a person subject to that subpoena." Rule 26(g) requires a certification that every discovery request not have an improper purpose of harassment or increasing litigation costs and that it

not be unreasonably or unduly burdensome or expensive "given the needs of the case... the amount in controversy and the importance of the issues at stake in the litigation." Clearly, the Federal Rules contemplate misuse of discovery and litigation as a method to access sensitive confidential commercial information and include appropriate safeguards.

Additional privacy laws that protect from disclosure various types of information, such as financial and medical information, include the Health Insurance Portability and Accountability Act of 1996; The Fair Credit Reporting Act; Privacy Act of 1974; Family Education Rights and Privacy Act; Right to Financial Privacy Act; Electronic Communications Privacy Act; Financial Modernization Act (Gramm-Leach-Bliley Act); Telecommunications Act; Privacy Protection Act of 1980, and numerous other privacy laws.

Indeed the Federal Trade Commission's Rules (16 CFR §§ 4.2(d), 4.9 and 4.10) recognize and extend protection from public disclosure over trade secrets, commercial or financial information, and competitively sensitive information, such as the type discussed herein.

RFID technology could render these laws moot since the sensitive commercial and consumer information will be in the possession of these concerns and discovery of use (or misuse) by business or consumers may be difficult if not impossible.

IX. Critical Privacy Issues Include:

1. What type of data will be contained in the RFID tag?

The tag should include information that is critical to identifying goods in the event they pose a threat to public health and safety such as lot code, expiration date, production facility, shift and line, date of manufacture. However, the FTC should be wary about non-essential information that could be used to thwart competition, such as track and trace codes, or information that details who handled the product when and where[24]. To the extent that such information may be useful for legitimate law enforcement purposes, the Commission should consider whether safeguards could be established that would limit access to such data to persons who have a legitimate reason to know the information (e.g. law enforcement

[24] See Appendix G, Benefits to Manufacturers – Reduce Diversion. The Executive Conference Produced by RFID Journal, March 28 to 31, 2004, Chicago, Illinois.

personnel).

2. What infrastructure manages the data?

Will the infrastructure be closed and controlled by a disinterested third party with limited access to data limited to law enforcement or subject to other privacy protections, or will the data be controlled by the marketers, Procter & Gamble and Gillette's of the world to do with as they want, or will infrastructure be open to the public so the world can access anything in the system over the Internet, an invitation for disaster. Each comes with its own list of issues, such as how does a person or business determine whether the data has been accessed and/or misused, what safeguards are in place to prevent information theft and/or identity theft, what safeguards are in place to protect the data from hackers and viruses or other corruption, and what steps are in place to correct errors or incorrect information? A national database will likely be created in the pharmaceutical industry for the purpose of verifying a drug is genuine. If the database is used for purposes other than this verification, it is subject to abuse by manufacturers. Accordingly, such a national database should be maintained, managed and controlled by an entity independent of participants to the database and access should be limited to the stated purpose (with records of such access maintained).

3. Who owns the data? Who controls the data?

Can an owner of a good protect their sensitive confidential commercial information to maintain its private? Will companies be allowed to share information with others? Will companies be able to opt out of sharing their data and how do they prevent retaliation for not sharing, for example say a large retailer insists that in order to do business with the retailer, the small distributor must share its data with it. This exposes the smaller distributor to ruin because the large retailer can, armed with the chain of distribution information, by-pass the small distributor on future transactions, eliminating the middleman. This is made possible by undue market power the Auto-ID/RFID creators have included in the technologies development and control of the RFID infrastructure. Indeed these same creators contemplate using the legislative process to mandate tracing and tracing under the pretext of a law enforcement tool[25], thus disguising

[25] October 17, 2002, Auto-ID Technology: Transportation and Logistics Adoption Forum, MIT Center for Transportation and Logistics. This track and trace requirement was proposed by the FDA at 21 CFR Parts 1 and 11 (published May 9, 2003 Federal Register, Volume 68, Number 90, pages 25187 to 25240). Ironically the nations largest food manufacturer, Kraft Food, stated that "...examining records occurs as part of the in-depth investigation which takes place after

the real benefit to them, the ability to track and punish discounters and those dealing with discounters.

4. Is the data considered intellectual property with the attendant rights?

Affording intellectual property type protections on invisible EPC codes imposes another set of trade barriers in that it creates a limited monopoly on the IP holder. Further, the EPC and its information do not deserve the protection of copyright and/or trademark laws; in many instances the data contained within a RFID database belongs to others. In short this issue needs to be addressed early on to avoid expensive and time consuming intellectual property litigation that the FTC is aware is a popular business tool often used to thwart or delay competition.

5. What limitations, if any, will be placed on the use or misuse of data? Should there be penalties or sanctions for misuse? Who enforces the rules? Should there be private rights of action for misuse?

Electronic records access and retention rules must be established (say for 2 or more years). Businesses and consumers should be informed in writing of access to data containing information about them, including if adverse action is taken such as terminating relationships with customers who sell outside their traditional channels or using the information to make financial or credit decisions (similar to the requirements contained in the Fair Credit Reporting Act).

A system needs to be in place that protects in the strongest manner possible misuse of information, be it business or consumer information. Sanctions should include criminal (felony) penalties and substantial monetary penalties (including punitive or automatic treble damages and automatic awards of attorney fees). Private right (and class action right) of actions need to be preserved in the system. Databases must have access and control records so violations are easily documented and violators may be swiftly punished. Misuse of the data makes it easy for identity theft, because the thief will know everything there is to know about a business and/or individuals purchase history. For example, as we

---

consumers have been warned about the potential harm associated with a product and have stopped using it. Tracing the movement of ingredients and products becomes relevant as investigators seek the "root" cause of the situation and gather the evidence needed to place blame, punish offenders, and prevent reoccurrence, but is of limited value in directly protecting consumers during a national emergency." see footnote 2 above.

speak today, many giant pharmaceutical manufacturers[26] have stopped supplying Canadian pharmacies unless they promise not to sell drugs to U.S. consumers looking for lower cost safe drugs.

6. Should businesses be permitted to opt out of the RFID system? Should manufacturers and/or large customers be permitted to require participation in the RFID system as a condition of doing business?

How does a Company protect its sensitive commercial business information that may be contained with the RFID infrastructure? How does RFID data interrelate between federal and state privacy laws and laws that protect consumer credit information, financial information, trade secrets, and unfair competition, what about the Rules of Civil Procedure and Evidence? They specifically protect commercial information from improper disclosure. The law fully protects the rights of competitor to keep commercial information as confidential as possible. The system must provide recourse to prevent highly sensitive confidential commercial information from disclosure and misuse.

X. Conclusion

The FTC investigation into privacy and marketplace implications of RFID technology is critical, small businesses and consumers concerns are not part of the Auto-ID Center/EPCglobal Networks agenda, rather it is the promotion of industry giants interest in owning and controlling its customers, the consumer and maximizing profits. It bespeaks of immense and powerful manufacturers and giant power buyer retailers using their muscle and resources to force RFID on small privately owned family businesses and consumers. There is no reason the FTC should not take appropriate action to afford consumers and commercial business information adequate protection to safe keep their confidential information. RFID will still work and achieve many of the purported benefits to business (increased efficiencies, accuracy and lower labor costs). RFID technology offers little benefit or value to the consumer. The consumer will ultimately pay for the cost of such new and unproven technology (such cost is estimated to be "astronomical") in the form of higher prices. The benefit to consumers is not commensurable to the consumer. The balancing scale in the case of RFID technology favors preservation of business and consumer privacy. Victory appreciates the opportunity to address the FTC on this important matter and would be happy to respond to questions.

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[26] Such as Pfizer, Eli Lily, GlaxoSmithKline and AstraZeneca

ADDENDUM C TO THESE COMMENTS IS DESIGNATED CONFIDENTIAL COMMERCIAL INFORMATION UNDER 16 CFR § 4.10

Respectfully Submitted,

Victory Wholesale Grocers,
a division of Brothers Trading Co., Inc.

By: James R. Office, Vice President
and General Counsel

Enclosures

APPENDIX A

Auto-ID Board of Overseers

Chep International
Coca-Cola
Dai Nippon Printing
Department of Defense
Ean International
Gillette Company
GlobeRanger
International Paper
Johnson & Johnson
Kimberly-Clark
Pepsi
Pfizer
Phillip Morris
Procter and Gamble
Target Corp.
Tesco Stores Ltd.
Uniform Code Council
Unilever
UPS
US Postal Service
Wal-Mart Stores, Inc.
Westvaco
Yuen Foong Yu Paper

APPENDIX B

October 26, 2000

Anthony L. Young, Esq.
Piper Marbury Rudnick & Wolfe LLP
1200 – 19th Street, N.W.
Washington, D.C. 20036

Re: Impact of New PDMA Rules on the Pharmaceutical Distributor Markets

Dear Mr. Young:

I have reviewed the role of distributors in the pharmaceutical industry and the likely impact of the FDA's proposed rule changes on their roles. As discussed below, I believe the result of the rule changes will be less resale of pharmaceuticals, fewer distributors and ultimately higher prices. In assessing the likely impact, I observed that a number of manufacturers, three somewhat overlapping levels of distributors, and end-users characterize the pharmaceutical industry. These various participants, my observations, and my conclusions are set forth below.

Manufacturers:

Large pharmaceutical companies manufacture most drugs. Upon introduction, patents protect most drugs. When the patent expires, manufacturers face competition from generic drugs but frequently continue to retain some name-brand market power over generics.[1] The monopoly power attained by the pharmaceutical companies is the legal reward for the research that went into the creation of the patented drug, and under United States patent law the manufacturers are entitled to this reward for innovation.[2]

National, Mid-Level and Local Distributors:

There are three partially overlapping layers of distributors. First, there are the "Big 5" manufacturers, who operate nationally.[3] They buy from the manufacturers. They sell much of their product directly to end-users (physicians, hospitals, nursing

[1] The name-brand drug generally sells at a premium over the generic, indicating the presence of some residual market power.

[2] Of course, it is well understood that a patent by itself is no guarantee of monopoly power. Monopoly power requires both barriers to entry (for example from patents) and a product demand curve which lies in part above the marginal cost curve.

homes and the like). But they also sell some product to smaller regional distributors and to a very large number of local distributors. These local distributors generally operate in very small geographic markets. The mid-level distributors sometimes buy from the manufacturers, and sometimes do not sell "down the chain," but rather to the Big 5. This occurs when the Big 5 can get better prices from the mid-level distributors than from the manufacturers.

End Users:

Pharmaceuticals are purchased by physicians, drugstores, hospitals, and other third parties who purchase drugs on behalf of patients, who of course are the real end users. But for all practical purposes, distributor sales to physicians, hospitals and so on constitute the end of the chain of distribution.

The Roles of Distributors:

In many markets, distributors play two quite distinct economic roles. The first is that suggested by the title – they distribute product from the manufacturer to the end user and provide services for both in the process. Manufacturers use distribution chains rather than selling direct because the distributors have expertise and contacts which they themselves lack. In this industry, it has been noted that "along with the delivery of pharmaceuticals, the wholesalers have a broad range of value-added services that they can provide to their dispensing customers. These services are often not provided by the manufacturer and would be difficult and costly for the dispenser (customer) to reproduce them."[4]

The second role of the network of distributors is that of arbitrageur. In any market in which the manufacturer has market power (a downward-sloping demand curve) there is the potential for substantial profits to arise from price discrimination. The standard textbook profit-maximizing monopolist charges a price above cost. But the market, even for a monopolist, restrains the price. If the price is raised too high, a small number of consumers will continue to buy the product but many others (too many others), who would have been willing to pay a somewhat lower price, opt out of the market.

[3] The Big 5 are Cardinal Health, Inc., Bergen-Brunswig Corp., AmeriSource Health Corp., McKesson Corp. and Bindley Western Industries, Inc.

[4] Memorandum Opinion, FTC v Cardinal Health, Inc., p. 6 (1998).

Of course, the monopolist (or any manufacturer with market power) would like to find a way to charge a high price to those relatively few who are willing to pay it, and to charge a lower but still profitable price to other consumers. In the extreme case, the manufacturer would like to tailor the price to fit the consumer, with consumer-specific prices ranging from high to low (down to pricing at cost or slightly above). If a monopolist is able to perfectly price discriminate – that is, to really charge the maximum price that every end-user is willing to pay, then he can earn approximately double the profit that he could earn by charging a single price to all customers.

From the manufacturer's perspective, price discrimination is frequently difficult to maintain because it opens the door to arbitrageurs. Distributors – unless they are somehow constrained from doing so – naturally undertake this arbitrageur's role.

Arbitrage:

Arbitrage is the art of buying low and selling high. An important fact to note is that arbitrage opportunities exist whenever the same product sells for different prices in different circumstances, but that arbitrageurs actually destroy arbitrage opportunities by their own actions. Clearly not everybody can buy low and sell high. Both the original seller and the original buyers will try to play off one arbitrageur against another. And in addition, as the seller's stock runs low he will raise his price. Correspondingly, as the buyer's demand is satisfied he will only offer a lower price.

The economic role of the arbitrageur, though not the role envisioned by the arbitrageur himself, is to enforce the **law of one price**. The law of one price states that in a freely functioning market, in which there are no artificial impediments to arbitrage, any given commodity must command only one price throughout the marketplace.

As the foregoing should make clear, if a manufacturer wants to engage in price discrimination, one of his first concerns is the elimination of arbitrage. In the parlance of distribution networks, the manufacturer must ensure that his distributors sell only to "target" customers. Frequently, manufacturers attempt to enforce exclusive territories (i.e., they attempt to prevent "transshipment"). Thus if a manufacturer finds it profitable to discriminate against one territory, he need not fear that his distributor in the favored territory will resell product and frustrate his effort to obtain the high price.

Environments in Which Price Discrimination Flourishes:

Successful price discrimination requires two ingredients: ability to identify end users with different willingness to pay, and ability to prevent end users or the distribution network from engaging in arbitrage. Probably the most effective environments for price discrimination are those in which it is physically impossible for the end user to resell the product. There is no resale market, no arbitrage, and a great deal of price discrimination in surgery and college education. There is also a great deal of price discrimination in airline tickets – not because it is physically impossible to resell tickets but because the airlines have succeeded in making it impossible for a ticket holder to resell all or part of his ticket. If tickets or legs of tickets could be resold on a secondary market, then airlines would be unable to charge a higher price for travelers (business travelers, with a high willingness to pay) premium prices if they do not stay over a Saturday night. If resale were possible (and there is no technical reason why it is not), then distributors would buy up low-priced tickets. They would "unroll" round-trip tickets into one-way legs and resell them. The Law of One Price would prevail.

In the case of pharmaceuticals there is no technical reason why they cannot be resold. However, if the manufacturers can control the resale market, they can prevent or greatly curtail the kind of reselling that would undermine price discrimination.

Arbitrage in the Pharmaceutical Distribution Industry:

I do not have data on the strength of arbitraging in the pharmaceutical industry. However, there is anecdotal evidence that it is prevalent. There are reported instances of lower-level distributors occasionally selling to the Big 5. This occurs despite the fact that the "natural" flow of drugs is from the manufacturer to the Big 5 and from the Big 5 either directly to the end user or to a lower-level distributor who in turn distributes to the end user. It is hard to imagine that these "upstream sales" are anything but arbitrage.

Furthermore, in an industry characterized by such a maze of distribution channels, with the Big 5 sometimes selling to wholesale distributors, sometimes to retail distributors, and sometimes direct to end users, one would expect healthy arbitrage.

Effect of the Rule Change on Arbitrage:

Perhaps even more than its effect on the number of small distributors, and the level of competition among retail distributors, is the effect of the proposed rule change on

arbitrage. The requirement that every transaction be documented with a pedigree all the way back to the manufacturer means that the manufacturers and the Big 5 have vastly increased control over the paths followed by drugs from manufacturer to end user. The Big 5 have already demonstrated this control by refusing to provide pedigrees or authorized distributorships to small distributors. As noted in more detail below, there is a District Court finding that local markets in this industry are "born to leak." This leakage, which will likely be greatly curtailed by the proposed rule change, is arbitrage in action.

Effect of the Rule Change on Value-Added Service:

The report of C. Daniel Mullins, Associate Professor of Pharmacoeconomics at the University of Maryland, documents anticipated changes in the number of viable distributors which will result from the proposed rule change.[5] He goes on to discuss the probable economic consequences of that destruction of distributors. I wish to note that the effect on competition is likely to be even more deleterious than he indicated in his report.

At present there are numerous distributors, some operating nationally, some regionally and some just locally. In FTC v Cardinal Health, *et al*, the Court found that there is a national market for drug wholesaling. Whereas in some regions there are well-defined local markets (basically the western half of the United States where competition from regional and local distributors is less intense), the eastern half of the country is characterized by a sufficiently thick layer of regional distributors that local markets are not easily definable. The Government's expert testified, and the Court agreed, that local markets are "born to leak." Whereas distributors in the western half of the country may enjoy some local market power, distributors in the eastern half of the country apparently do not.

If the proposed rules force the closure of a sufficiently large number of regional and local distributors, then it is reasonable to anticipate that the multistate (largely east of the Mississippi) market would be transformed into a set of autonomous local markets. Instead of X distributors competing against one another throughout the eastern United States, we may end up in a setting where one or two regional/local distributors serve each local area. To take a hypothetical, suppose that the rule change reduces the number of

[5] Dr. Mullins' report does not provide a precise estimate of the number of distributors which will be forced to exit the industry, but he clearly demonstrates that there will be a major effect on smaller distributors.

distributors from 40 to 10.[6] If the distributors are of equal size, and if they all compete throughout the region, the HHI is raised from 250 to 1000.[7]

But now suppose, reasonably, that the rule change not only reduces the number of distributors from 40 to 10, but also greatly curtails transshipment of pharmaceuticals. The Eastern United States is transformed from a single regional market to many local markets. Although these markets were "born to leak," the proposed rule has stopped or at least greatly curtailed the leaking. Suppose for example that many or all of the surviving regional distributors concentrate in only 1/3 of the region's local markets. Secure in the knowledge that the new rules have stifled transshipment of drugs, the distributors recognize that they have local monopoly power. If three subnational distributors now serve each local market, the local HHI will have risen all the way from 250 to 3333. The reason is that the rule change not only directly reduces the number of distributors, but it also potentially increases the autonomy of local markets. In one of the antitrust defendant's favorite phrases, it "brings order to the marketplace."

Of course, the very likely effect of isolating local markets and reducing the number of distributors is to raise prices. This effect is different from, but related to, the effect described earlier – that of facilitating price discrimination. On both counts, the proposed rule change is likely to have a seriously deleterious effect on the price of pharmaceuticals and the level of service end-users will receive.

Sincerely,

Bruce W. Hamilton, Ph.D.
Professor of Economics

[6] I emphasize that these numbers are illustrative. I have not performed a detailed econometric analysis to determine the exact pre and post rule-change market shares.

[7] Market concentration is a function of the number of firms in a market and their respective market shares. As an aid to the interpretation of market data, the FTC and DOJ use the Herfindahl-Hirschman Index ("HHI") of market concentration. The HHI is calculated by summing the squares of the individual market shares of all the participants. FTC/DOJ Horizontal Merger Guidelines, § 1.5.

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Bruce Hamilton came to Johns Hopkins as an Assistant Professor in 1973, one year after obtaining his Ph.D. from Princeton University. Since that time he has spent his entire career at Hopkins, with the exception of a one-semester Sabbatical leave at Bilkent University in Ankara, Turkey. He was made Professor of Economics in July 1983, and served as Acting Chair during spring term, 1993-94. He then served as Department Chair from July, 1985 through June, 1992.

Dr. Hamilton is an applied microeconomist. Until approximately 1985, virtually all of his research was in the broad field of urban economics, with specialties in urban public finance and urban transportation. His work during the 1970s on the Tiebout Hypothesis led to a resurgence in professional interest in the workings of local public economies.

Subsequently, Dr. Hamilton's research has been more eclectic. He has recently published a paper on the economics of professional sports stadia, with emphasis on the new stadia in Baltimore. He has a working paper on the causes of the recent (two-decade) dramatic rise in automobile longevity. This work shows that essentially all of the longevity improvement is unrelated to any improvements in the inherent durability of cars themselves.

More recently he has used a food-demand function and the PSID data set to estimate the annual bias in the Consumer Price Index, separately for whites and blacks. As this method has very limited data requirements, he is currently determining whether the technique might fruitfully be applied to the measurement of inflation in other countries, including developing countries whose data are poor.

Dr. Hamilton teaches the Elements of Microeconomics course in the undergraduate curriculum, as well as an upper-level seminar on the Economics of Antitrust (jointly taught with antitrust attorney Robert Levy). In the Ph.D. program he teaches the first course in the Microeconomic Theory sequence.

Curriculum Vitae

APPENDIX D

PEPSICO
Beverages & Foods

Everything You Always Wanted To Know About Diverting But Were Afraid To Ask

Dennis Donelon & Mark McGowan

Pepsi Beverages and Foods

GMA IS/LD Conference
March 23, 2004

Diverting Overview

Introduction To Diversion - An Insidious Form of Arbitrage

What Is Diversion?

Product originally sold by a manufacturer at a discounted price because the product was intended for a particular purpose (e.g., sampling) or for a certain channel (e.g., foodservice or overseas customers), is then resold by the first buyer, often in violation of the original intent, to a different party. Diverting is profitable when the difference between normal price and net price (due to discounted sale price, the availability of trade deal money, or a combination of the two) is sufficiently great that there is profit in reselling the goods, even with additional handling costs incurred.

Is Diversion Legal?

Generally, in the absence of a lawful contractual obligation to the contrary (e.g. a sampling program where there is an express provision stating that the product is sold at a discount only for distribution as part of such a program) resale of goods is not illegal. Indeed, conditioning the sale of goods upon receipt of certification by the buyer that it will not resell could implicate Section 1 of the Sherman Act which prohibits restraints of trade which are the product of "contract, combination...or conspiracy" and which are "unreasonably restrictive of competitive conditions." What we refer to as "Diversion" is often called "Transshipping" by those who defend it as a *pro-competitive* outgrowth of differential pricing for the same goods in the marketplace.

However, remember in many cases product is obtained via unlawful or fraudulent means.

Diverting Overview

Who Are These Diverters?

There are professional diverters but legitimate distributors and even legitimate retailers also engage in it. The professionals utilize many different methods and schemes (see below "Characteristics of Diverters"). The largest full-time diverters may do as much as $2 billion per year.

It is likely that some of the big-time professional diverters are connected with organized crime.

It isn't likely that you will be contacted directly to do business with one of the big diverting firms. They prefer to work through agents, including persons who identify themselves as buyers for a retailer but buy on behalf of the diverter.

Additionally, otherwise legitimate retailers and distributors engage in diverting on an opportunistic basis, taking advantage of discounts or trade deals to buy more than they truly need, knowing that they can sell the excess and increase their overall margins. It is our understanding that some retailers actually have "diverting desks" which engage in both "outgoing" diverting (re-selling to others product that they bought) as well as "in-bound" diverting (purchasing product for themselves from diverters). The PepsiCo Beverages and Foods Diverting Policy addresses both situations:

Diverting Overview

PepsiCo Beverages & Foods Diverting Policy

While it has long been The PepsiCo Beverages & Foods' policy to oppose the practice of "Diverting", the realities of today's marketplace make it impractical to expect that a Customer would never purchase product at a lower cost from a third party. Therefore, while we continue to discourage Diverting, we recognize that our Customers may occasionally purchase product via "In Bound Diverting". **We Will Continue to Oppose all instances of "Out Bound Diverting" by our Customers.**

We reserve the right to limit quantities shipped to any Customer and to terminate any collaborative replenishment activities beyond normal shipping means. We are a "Pay For Performance" company, so our Trade Deals require performance with the Customer in the Market Area where purchased. Therefore, the amount of trade funding available to a customer could be reduced if that customer engages in Diverting of PepsiCo Beverages & Foods products.

PepsiCo Beverages & Foods wants to partner with customers to build profitable volume for both parties. We will maintain a list of third parties that regularly engage in diverting activities to ensure that we are not selling to known Diverters. Additionally, PepsiCo Beverages & Foods will continue to put significant resources and processes into place in an effort to further reduce "Diverting Opportunities."

All PepsiCo employees selling PepsiCo Beverages & Foods retail products shall abide by this policy. Willful violation or neglect of the policy against outbound diverting may lead to disciplinary actions including possible termination.

Diverting Overview

CHARACTERISTICS OF DIVERTERS

Aliases: Diverters often use personal and corporate aliases to disguise their true identity.

Cash transactions: Include letters of credit, money orders, etc. These not only shroud the person or company from scrutiny, but guarantee the seller of being paid.

Multiple Companies: "Stables" of companies to do transactions. Some of these will actually be legitimate.

Priors: Diverters and counterfeiters often have a long history of untoward activity. They will move from product to product if identified by a particular industry.

Associates: Diverters flock to certain freight forwarders, attorneys, and banks that are "accommodating."

Phoney Addresses: Diverters often use "accommodation addresses" such as commercial mail drops or "Brass Plaque" companies.

Untraceable Email: Diverters regularly communicate by Hotmail, Yahoo or MSN accounts. They change these frequently.

Trade Bulletin Boards: Diverters and their brokers routinely advertise on Trade Bulletin Boards, but quickly shift to untraceable emails when they get prospects.

Vanishing Act: When they even think they have been detected, counterfeiters and diverters can quickly close shop and resume operations in another location. There have been numerous occasions when they have abandoned large amounts of merchandise rather than be apprehended.

Diverting Overview

How Do Diverters Operate?

Whether it's a professional, large-scale diverter, a smaller distributor with both legitimate and illegitimate business, or a retailer engaging in outbound diverting, diversion operates similarly. Acting as an arbitrageur, the buyer pursues the opportunity to buy at a deeply discounted sale price or on especially favorable deal terms. Ideally for the diverter, he arranges a customer pick up using his own carrier. In that case he can simply have the diverted product delivered immediately to his customer, thereby avoiding storage charges. If the diverter does take possession and holds the product he may rework or relabel it to make it retail saleable. If the discount is deep enough it may even payoff to have the product shipped out of the country and then shipped back into the U.S.

Diverters create fraudulent documentation including falsified bills of lading, invoices and ocean bills of lading in order to make their transactions appear legitimate..

The availability of product is often announced on websites and over the "diverter wire", a network of internet-enabled communications ranging from websites to trade bulletin boards, to chat rooms. However, should it become well established that a manufacturer's product is almost always available over the diverter wire these sorts of overt communications are no longer necessary.