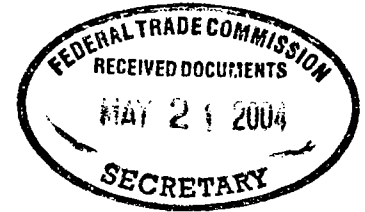




ORIGINAL



May 20, 2004

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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:

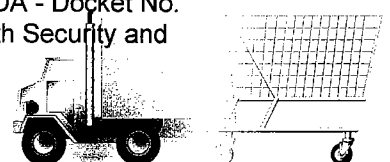
Victory Wholesale Grocers (“Victory”) appreciates the opportunity to submit these comments to the Federal Trade Commission in connection with the “RFID Workshop.” We will address several issues; including the privacy concerns to small privately owned businesses. Another issue deals with anti-competitive 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 businesses¹. 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

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”).

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the consumer in the form of higher prices without any commensurable benefit to the consumer³.

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 possess 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.

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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 one⁴. 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

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.

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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

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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 materials⁶, 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

⁵ See Appendix B.

⁶ See Appendix C and D.

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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 diverters⁷. 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

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

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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 schemes⁸. 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.

