

Summary of Modifications to the Designated Suppliers Program September 29, 2006

The following summarizes modifications that the Designated Suppliers Program (DSP) Working Group has made to the DSP¹. These modifications are designed to address key concerns that have been raised about the program and to enhance its effectiveness and administrative efficiency.

Freedom of Association/Union Requirement

The problem: Objections have been raised to the union requirement on the grounds that 1) it will unfairly exclude factories that respect associational rights but where workers have freely chosen not to unionize; 2) it will in effect require workers to join unions.

Original plan: In order to qualify for the DSP, there must be a union or other representative employee body in the factory.

New approach: DSP factories are not required to have a union or other representative employee body. In order to qualify for the DSP, a factory that does not have a union may demonstrate compliance by taking the steps necessary to ensure that workers at the factory can freely exercise their associational rights.

Additional details: Factories will be required not just to respect associational rights in a passive manner, but to take proactive steps to create an environment in the factory within which workers can make a genuinely free choice about unionization. These steps include communicating clearly to workers the factory's willingness to bargain in good faith with any duly constituted union and maintaining scrupulous neutrality with respect to workers' choice about unionization – making no attempt to influence this choice, whether through coercion or persuasion, and training all supervisors and managers to ensure that this obligation is understood and followed.

Advantages of this approach:

- 1) Addresses the concern that the DSP would exclude a factory where management respects the right of workers to unionize but where workers have nonetheless freely chosen not to do so.
- 2) Includes stringent requirements to ensure that factory managers take the steps necessary to undo the effects of any past anti-union coercion.

¹ These changes are reflected in the Working Group's revised program overview, titled "Designated Suppliers Program – Revised".

Enforcement of the Fair Price Standard

The problem: Objections have been raised to the idea of the WRC determining what is and is not a fair price.

Original plan: In the event of a dispute as to whether the price offered by the licensee meets the standard, a complaint is made to the WRC and the WRC investigates and determines whether the price is fair.

New approach: In the event of a dispute, the matter will be resolved through binding arbitration between the licensee and the factory, with the two parties choosing a neutral arbitrator possessing the requisite expertise. The arbitrator's decision will be binding on both parties. The WRC will have the ability to observe and provide input to the arbitrator, but will not have decision-making power.

Additional details: Either side may trigger arbitration. The cost of the process (compensation, travel and other expenses for the arbitrator) will be borne by the two parties, with the licensee covering the majority of the costs. The arbitrator will be selected jointly by the factory and licensee. To assist with the selection process, the WRC will provide a list of qualified arbitrators, but licensees and factories will not be required to select an arbitrator from this list. In all cases, the arbitrator will issue a brief public report on the outcome, which will not include any proprietary data from either party or any specific price information. The WRC will ensure that such reports are issued and made available to universities.

The WRC will have the right to observe arbitrations, review documentation, and provide input to the arbitrator – which the arbitrator may consider at his or her discretion. The WRC will also report periodically to universities on whether the arbitration process is functioning effectively.

Advantages of this approach:

- 1) The power to determine whether a price is fair no longer resides with the WRC. This will make licensees more comfortable. It reduces the WRC's administrative and enforcement burden. It addresses the concern that the WRC has too much overall power in the enforcement of the DSP.
- 2) The cost associated with the arbitration process will give both the licensee and the factory an incentive to settle disputes without arbitration.
- 3) Allowing the WRC to observe ensures that universities have a window into the process and will be informed, in a timely fashion, if the process is failing to ensure adequate prices. Allowing the WRC to provide input to the arbitrator ensures that the worker rights implications of the price dispute are given consideration.

Disputes Concerning Compliance Assessments

The problem: The concern has been raised that the DSP implementation plan does not provide any recourse for licensees if they believe the WRC has mistakenly or unfairly deemed a factory not to be in compliance with the labor standards.

Original plan: The WRC is the sole authority on compliance matters.

New approach: Licensees and factories may appeal a WRC compliance decision to an expert appeals panel.

Additional details: The panel will be comprised of independent labor rights experts, chosen through a multi-stakeholder process in which licensees will participate. In order to access the appeals process, the licensees will have to demonstrate to the panel that they possess substantial evidence that the WRC's decision was erroneous. Panel members will be free of any financial conflict of interest (i.e. they will be individuals who are not employed by an apparel brand, a factory, a union, etc.).

Advantages of this approach:

- 1) The appeals process will reassure licensees about the fairness of the program.
- 2) The process will ensure that if factual errors are committed in the compliance assessment process, there will be a means to correct them.
- 3) The process will increase the overall transparency of DSP enforcement.

Obligations of Small Licensees

The problem: The concern has been raised that the DSP might prove very burdensome to small licensees (and to licensees who sell highly specialized apparel products).

Original plan: The DSP applies to all apparel licensees, regardless of their size or specific product types.

New approach: The DSP will apply only to licensees whose annual wholesale sales of university logo goods are in excess of a specific dollar amount, as reported by the Collegiate Licensing Company and the Licensing Resource Group. Small licensees will thereby be exempted from the program. In addition, exemptions will be granted to licensees that can demonstrate that the majority of their university logo apparel production consists of products so highly specialized that they cannot be produced alongside other, more common apparel products, and are not sufficient in volume to constitute the majority of any factory's production.

Additional details: In order for the Working Group to determine the best cut-off point for this small licensee exemption, additional consultation is needed with CLC and LRG to determine the level of sales of different licensees. The goal is to ensure that licensees that

have neither the production volume necessary to influence any factory substantially, nor the financial resources to participate actively in the compliance process, are exempted. If the sales of a licensee that is initially exempt subsequently exceed the threshold, the licensee will lose its exemption.

Advantages of this approach:

- 1) Exempts from the DSP small and local licensees that do not have the resources to be active participants in the implementation and enforcement of the DSP.
- 2) Simplifies the administration of the program by exempting a large number of companies without substantially reducing the impact of the DSP (because small licensees, while numerous, account for only a small percentage of collegiate apparel sales).
- 3) Does not expose larger licensees to unfair competition from exempted licensees, because, as noted, any licensee whose sales rise above the cut-off will lose its exemption.
- 4) Small licensees will still be obligated to comply with existing university codes of conduct and enforcement programs.

Factory Selection Process

The problem: The concern has been raised that the DSP's multi-stage factory selection process is too restrictive and cumbersome for licensees.

Original plan: Licensees, factories themselves, universities, and worker advocates are invited to nominate factories. Nominated factories, or the licensees on their behalf, must then provide the WRC with substantial documentation of the factory's labor rights performance. From this large pool of nominees, the WRC first eliminates facially unqualified candidates based on a review of the application data. The WRC then conducts initial compliance assessments at all remaining facilities and, based on these initial assessments, further narrows the pool of nominees to a list of "candidate" designated suppliers – factories the WRC believes have the capacity to meet the program's standards. From this list of candidate factories, licensees then select those they intend to use for DSP production. Following these selections, a remediation plan is developed for each factory, addressing outstanding compliance issues. When remediation efforts are complete, a full assessment is conducted by the WRC, covering all issues except living wage, and, if the factory is deemed to be in compliance, "provisional" designated supplier status is granted. Full designated supplier status is granted when both the union at the factory, and factory management, have reported that they have agreed to a contract including wage levels consistent with the DSP's living wage standard.

New approach: Licensees select the candidate factories, without any pre-screening process. Licensees are free to choose any facility they intend to use for DSP production and which they believe can meet the program's standards. The WRC consults with each selected factory to ensure that management is fully aware of its obligations under the

DSP. The licensee works with the factory to address any outstanding compliance issues; the WRC assists as requested. At a time of the licensee's and/or factory's choosing, but no later than six months into the first program year, the WRC conducts a full compliance assessment, covering all code standards and provisions of the DSP. Designated supplier status is granted to the factory if it is determined to be in compliance.

Additional provision: There have been a small number of factories that have achieved and maintained substantial labor rights improvements, due in significant part to intervention under university codes of conduct, undertaken in response to worker complaints. Because of the long-standing relationship between many universities and these facilities, and because of the principle that demonstrated compliance should be rewarded, it is important to ensure that these factories are supported as universities transition to the DSP. For this reason, in the first year of the DSP, any licensee that used one of these factories for collegiate production at any time between June 30, 2001 and July 1, 2006 will be required to contract with that factory as one of its DSP facilities, provided the factory wishes to participate in the DSP and is able to meet the labor standards. Licensees with small supply chains will be exempted from this requirement, in order to ensure that the requirement does not unreasonably restrict licensees' sourcing options. Only licensees that have twenty or more collegiate production facilities (prior to the implementation of the DSP) will be subject to this requirement. The list of factories to which this provision will apply, as determined by the WRC, is as follows:

BJ&B (Dominican Republic)
 Lian Thai (Thailand)
 Mexmode (Mexico)
 PT Dada (Indonesia)
 PT Kolon Langgeng (Indonesia)

Advantages of this approach:

- 1) The factories preferred by licensees are not required to undergo an extensive pre-screening process before they can become candidate designated suppliers. This increases the freedom of licensees to choose whichever factories they wish and streamlines the selection process.
- 2) It is not necessary under this approach for the WRC to assess a long list of nominated factories and application materials, and conduct multiple initial reviews, in order to identify the candidate factories. This stage is removed. Only those factories that licensees identify, and actually intend to use for DSP production, will be assessed. This means that far fewer factories will need to be reviewed.
- 3) Because the WRC is no longer providing a list of candidate factories from which licensees must choose, the WRC is not responsible for ensuring that the available factories are capable of meeting licensees' production needs. Licensees will be free to select factories that meet their production needs.
- 4) The additional provision concerning the five factories named above will ensure that the removal of the union requirement, which would have made these factories

a logical option for licensees, does not result in these factories being excluded from the program. At the same time, it is a narrowly-drawn provision that will have only a modest impact on a small number of licensees

Two-Thirds Requirement

The problem: Licensees have stated that some collegiate products are so seasonal (in terms of sales and therefore production) that it is difficult or impossible for a factory to devote two-thirds of its annual production to these products – that this would leave a factory idle much of the year and overtaxed during production peaks. Licensees have also stated that this requirement unduly limits their flexibility in making production decisions.

Original plan: In order to qualify for the DSP, two-thirds of a factory's production must be for the university market and/or for other buyers willing to honor the DSP's labor and price standards.

New approach: In order to qualify for the DSP, a majority of a factory's production (i.e. 50% plus one) must be for the university market and/or for other buyers willing to honor the DSP's labor and price standards. In addition, licensees can obtain an exemption from the DSP if they can demonstrate that the majority of their university logo production is of a product or products subject to such extreme seasonal sales fluctuations that it is not feasible for a factory to devote the majority of its annual production to such a product or products.

Advantages of this approach:

- 1) Increases the freedom of maneuver of both factories and licensees.
- 2) Reduces the production scheduling challenges for factories and licensees created by the seasonality of some products.

Length of Licensee-Supplier Relationships

The problem: The concern has been raised within the Working Group that the problem of licensees jumping between factories could still continue, even when the DSP is in place, because licensees could still jump from year-to-year from one DSP factory to another.

Original plan: The DSP assumes long-term relationships between licensees and suppliers, but contains no specific mechanism to ensure that this goal is achieved.

New approach: A licensee will be required to have a long-term contract with each DSP factory it selects.

Additional details: The contract, which will be for a minimum of three years, will not include specific orders, products, or prices; it will only commit the licensee to place at

least enough orders at the factory, each year of the contract, to fill a specific percentage of the factory's production capacity (at least 50%, unless multiple licensees are using the facility). The contract, which the licensee and the factory will negotiate, will incorporate the fair price standard and will also include "out" clauses – allowing the licensee to withdraw from the contract if the factory fails to meet agreed upon quality standards (despite a good faith effort on the part of the licensee to help correct the problem); if the licensee loses its university license (or suffers some other setback that prevents the licensee from continuing to purchase the relevant products), or if the factory loses its DSP status. Any dispute between the licensee and the factory – over the fairness of the price for an order, or over an effort by the licensee to exercise one of the "out" clauses – will be resolved through binding arbitration (by a neutral arbitrator selected by the two parties).

If the licensee decides not to renew its contract with a factory and to leave at the end of the three-year term, the licensee will be required to offer the factory a transition year: a renewal of the contract, under the same terms, for one year, but at a reduced level of order volume (50% of the level stipulated in the expiring contract). The purpose of this mechanism is to give the factory the ability to make an orderly transition back to the non-university market. (Concern has been expressed within the Working Group that there is a risk of DSP factories losing business when their three year contracts expire, that the greatest risk will be borne by unionized factories with higher cost structures, and that this could have the effect of undermining associational rights. The Working Group intends to discuss this issue further.)

Advantages of this approach:

- 1) The stability of the system is greatly enhanced; licensees are prevented from jumping between factories year to year.
- 2) This makes the program significantly more attractive from the factory perspective and will therefore increase the incentive of factory managers both to enter the program and to maintain compliance with the labor standards on an ongoing basis.
- 3) An up-front commitment of long-term orders will reassure factories, for whom the DSP will be a very new concept, that the promise of stable orders at fair prices is a serious one. This will reduce the chance that factories will hedge their bets, particularly on the issue of associational rights – dragging their feet on full compliance while waiting to see whether stable orders really materialize.
- 4) The longer time horizon will make it easier for the factory to schedule production efficiently, reducing any complications that may be created by the move to majority collegiate production (e.g. seasonality of production).
- 5) Job security for workers will be increased, an essential goal of the DSP.
- 6) Licensees will still be able to leave a factory in the event of major quality (or other production) problems or adverse business circumstances that preclude the continuation of orders.

Living wage

The problem: The concern has been raised that granting the WRC sole authority to determine living wage levels places too much power in the hands of one organization.

Original plan: The specific living wage level for a given location is determined by local experts, identified by the WRC, who construct a culturally appropriate market basket of goods and services and determine the price for each of these goods and services in local markets. There is no process for appeal if the accuracy of the WRC's determination is disputed.

New approach: If a licensee, a factory, or a union believes that a wage level determined by the WRC is inaccurate, an appeal may be made to an expert panel.

Additional details: Appeals will be heard by an international panel of experts, chosen through a multi-stakeholder process (as with appeals of compliance decisions). Decisions of the panel will be final and binding on all parties.

Advantages of this approach:

- 1) The appeals process will reassure licensees about the fairness of the program.
- 2) The process will ensure that if factual errors are committed in the calculation of living wages, there will be a mechanism to correct the error.

Note on legal issues: A Business Review Letter will be requested from Department of Justice, to ensure that the DSP, in its modified form, is consistent with U.S. Anti-Trust law.