

Memorandum

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ATTORNEYS AT LAW

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To: Board of Trustees
National Association of College Stores

From: Marc L. Fleischaker
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Re: Designated Suppliers Program: Points to Consider

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Some colleges and universities around the country are urging their college stores to take action against poor working conditions at factories around the world that produce t-shirts, sweatshirts, and other apparel bearing the schools' names and logos. One proposal gaining support among some stores and students is the "Designated Suppliers Program" (DSP), under which schools would require their licensees to source licensed apparel from a small number of factories that have taken certain steps to demonstrate a respect for workers' rights. These factories would, among other criteria, pay a living wage and would allow factory workers the opportunity to be represented by a union or other representative employee body.

The National Association of College Stores (NACS) shares the DSP's ultimate goals of better working conditions for those people who manufacture the products our stores sell. NACS joins those who continue to seek better ways to achieve those goals, including the Fair Labor Association (FLA), the Workers Rights Consortium (WRC), and the United Students Against Sweatshops (USAS). NACS members feel strongly about the DSP program—on both sides of the debate.

There is no question that the DSP would significantly change the current system of sourcing collegiate-branded goods. Those schools considering adopting the DSP must determine whether the advantages to factory workers promised by those changes would outweigh its potential downside with regard to apparel availability and quality, licensing relationships, and legal challenges. Before making any decision of this type, NACS believes a full discussion of the pros and cons benefits everyone, and that college stores should be actively involved in the discussions.

This memorandum seeks to fill that gap for NACS members, as well as for campus administrators with oversight responsibilities over their school's store. At this time, NACS believes further development and modification of the DSP is needed before recommending endorsement.

Background

In the 1990s, college campuses saw a rise in public awareness around the issue of “sweatshop labor”—poor working conditions in the factories manufacturing collegiate emblematic apparel, athletic wear and other merchandise bearing school insignia and logos. Students organized, protested and convinced a number of colleges and universities around the country to take action to ensure that school-licensed products were not sourced from factories that mistreated their workers. Organizations such as the FLA, WRC, and USAS emerged to address these issues. Additional information about each of these organizations can be found at the end of this memorandum.

Among the most prominent of the actions taken by these organizations and schools was the adoption of “codes of conduct.” Under these codes, schools required their licensees to take various measures to address working conditions for factory workers. Code standards addressed issues such as employee health, safety, wages, etc. Monitoring and auditing programs were put into place to track compliance with these standards.

Over the past few years, dissatisfaction has arisen on some campuses regarding the effectiveness of these monitoring programs, as well as with the codes themselves. Calls have been made for schools to take more direct actions to address factory conditions. While colleges and universities, collegiate licensees and other stakeholders agree that worker conditions can and should be improved, significant disagreement remains regarding how best to effect the needed changes.

DSP Details

One proposal currently receiving a significant amount of attention among the university community is the DSP. Developed by USAS, the DSP has been the centerpiece of a recent “Sweat-free Campus Campaign” involving student demonstrations at more than 40 universities and colleges across the country. The DSP would require collegiate licensees to produce collegiate logo apparel in factories designated by the WRC as satisfying certain criteria, including respecting workers’ right to organize and paying workers a living wage.

The following is a summary of some of the major points of the DSP, taken from materials available at the websites referenced at the end of this memorandum, and from updated materials released as recently as September 2006.

- The DSP applies only to apparel and textile products, and to production facilities involving sewing and assembly. A participating school can determine later whether to expand the DSP to other products.
- Small licensees with collegiate apparel sales below a certain (as yet undefined) threshold are exempt.

- A participating school would require that its logo apparel licensees must:
 - Source a set percentage of their collegiate logo apparel from WRC-designated factories. Subcontractor factories must also be designated, and contract labor cannot be used to circumvent the DSP standards.
 - Place enough business in each of their DSP factories so that over 50% of the factory's total output in a given year is for the collegiate market (or for any non-collegiate buyer willing to abide by the DSP's labor and fair price standards). If a DSP factory is used by more than one licensee, the combined total of the licensees' orders must exceed this 50% threshold.
 - Phase in implementation over three years—following an initial six-month grace period, 25% collegiate logo apparel must be sourced from designated factories following the first year of implementation; 50% following the second year; and 75% following the third year.
 - Pay factories enough to make payment of a living wage feasible. If a dispute arises between the licensee and the factory over appropriate price levels, the two parties must submit to binding arbitration, conducted by an arbitrator chosen by both parties.
 - Enter into a long-term (at least three year) production agreement with each of their DSP supplier factories. The contract must commit the licensee to a minimum volume of orders per year, although licensees will have the right to break the contract before expiration if the factory fails to meet labor or production standards.
 - Disclose the existence of their contracts with each designated factory, as well as production volume data necessary to assess compliance with the sourcing requirement. All non-proprietary financial information regarding licensee compliance with sourcing and majority production requirements will be publicly reported.
- WRC-designated factories must:
 - Demonstrate, through independent verification, full compliance with existing college and university codes of conduct.
 - Demonstrate respect for workers' associational rights, either by the presence of a union or other representative employee body to represent workers, or by taking the steps necessary to ensure that workers can make a free choice about unionization, without fear of reprisal. (An early unionization requirement has been eliminated.)

- Demonstrate that they are paying employees a living wage, once they are receiving prices for products sufficient to make this feasible.
- Produce over 50% of their product for the university logo goods market, or for other buyers committed to these standards.
- Allow university enforcement agents unobstructed access to the factory when requested and provide annual disclosure of the production data necessary to determine whether the factory is producing a majority of their goods for the collegiate market.
- If a dispute arises over appropriate price levels, the licensee and the factory must submit to binding arbitration, conducted by an arbitrator chosen by both parties.

DSP Reasoning

Although the DSP involves major changes to current collegiate logo apparel sourcing, its proponents argue that such changes are necessary to create an atmosphere in which meaningful improvements in worker treatment can be achieved. Proponents of the DSP have characterized the current environment of apparel sourcing as a “race to the bottom,” as collegiate licensees seek lower prices, quick turnaround from suppliers, and new fashions, fabrics and products. It is argued that factories have shown an unwillingness to change employment practices at a given brand’s behest because brands do not currently make a commitment to these factories beyond the current production season. Improved employee treatment has not always guaranteed continued work for factories if prices rise as a result.

To address these systemic problems, DSP proponents seek to provide an environment in which factories are provided an incentive to improve working conditions. By agreeing to pay more, collegiate licensees will attract and maintain motivated factories to participate. By entering into long-term agreements with these factories, the argument goes, the factories can have confidence that the steps they take to improve working conditions will not result in lost contracts. Keeping the number of designated factories relatively small is intended to ease the burden of compliance monitoring. Requiring designated factories to service only or primarily the collegiate logo market will ensure that market factors from other apparel customers will not exert marketing pressures to evade compliance.

Concerns Regarding the DSP That Could Impact College Stores

All parties to this discussion are in favor of improved working conditions for the employees of collegiate apparel factories. Nevertheless, concerns have arisen regarding the methods by which the DSP intends to change the status quo. The measures the DSP requires have been challenged, most publicly by the FLA. Various vendors have also expressed concerns with the proposals.

The practices the DSP envisions would dramatically change a collegiate licensee's ability to source products. Concerns that have been raised by the FLA and others regarding these changes include:

- *The potential for antitrust violation charges.* These are discussed separately below. It has recently been decided that a Business Review Letter will be requested from the Department of Justice, to ensure that the DSP, in its modified form, is consistent with U.S. antitrust laws.
- *Significant supply disruption.* Consolidating a supply network of thousands of factories will drive certain licensees away from the college market. Some licensees may wish to avoid doing business with factories that also service their competitors. Others may seek the unique styles and fashions of factories that choose not to participate in the DSP. Some licensees may choose to continue to work within their own code of conduct compliance programs, while others may not be able to conduct their business within the restrictions the DSP imposes. Some have expressed concern that the program will be more feasible for a larger school than for smaller institutions.
- *Negative impacts on workers at factories that are not designated, and which thereby lose business.* Collegiate apparel manufacturing currently employs thousands of factories around the world. Many of these factories have worked with licensees for a number of years, developing relationships and compliance practices to meet existing codes of conduct. Disrupting these existing supply chains will displace workers and erode existing worker rights progress that has been made through these relationships. (In an attempt to address this issue, those licensees that have previously contracted with one of a small number of identified factories will be required to contract with that factory as one of its DSP facilities, assuming those factories choose to participate in, and meet the criteria of, the DSP program.)
- *Political backlash, particularly against public colleges and universities.* The type of market control envisioned by the DSP and anticipated price increases at the retail level of more than 5% may not be well-received by the public, despite the good intentions at its core. This could lead to negative publicity against a particular school, or even state legislation restricting DSP participation.
- *Decreased sales.* Higher licensing fees, combined with supply disruption and limited variety, will impact college store sales.

Manufacturing cost increases are an essential aspect of the DSP, but how these increases will ultimately be absorbed—by the licensee, the school or the consumer—remains to be determined. While there may be some amount of elasticity in the collegiate logo apparel market, particularly at schools with successful athletic programs, experience has shown that students and parents can demand and receive political support if they perceive they are overpaying at college stores.

We are all aware that college stores have been the recent target of intense criticism regarding the high price of college textbooks. Although the stores themselves are usually the participant in the supply chain least likely to have major control over textbook prices (which can be influenced by publishers, professors, school administrators, and copyright laws), the stores often receive the brunt of the criticism for high prices, late or faulty information regarding course requirements, and the inability of students to resell certain texts.

An increase in the price of school logo apparel, combined with the potential of limited availability of certain fashions, could cause further erosion to the markets and goodwill of college stores. This may prove true despite the altruistic motives at the root of these changes.

Antitrust Issues

The FLA, as well as some attorneys, has suggested that the DSP has serious antitrust issues, and that schools and stores should be reluctant to participate for this reason. Our review has indicated that these concerns are serious and not yet resolved. They deserve additional, careful consideration before there is wholesale agreement with the program.

This memorandum is not intended to include a complete analysis of the antitrust issues the DSP involves, but simply to identify some of these issues. In that regard, it may be helpful to contrast the DSP with another recent initiative that has been undertaken to address some of the concerns surrounding the working conditions of those in the garment manufacturing industry.

A group called the Fair Factories Clearinghouse (FFC), open to all retailers and brands, has plans to own and operate a database in which members could exchange information about factory workplace conditions, in order to improve the collection and sharing of this type of information. The information on the database would be a result of factory audits commissioned by member companies, and would include information regarding terms and conditions of employment, wages, use of underage labor, workplace safety and similar matters. Individual FFC members would then use that information to support their own decisions about where to source their products.

To ensure the legality of this proposal, the FFC sought a Business Review Letter from the Antitrust Division of the U.S. Department of Justice. The Antitrust Division's June 19, 2006 Business Review Letter responded to the FFC's request. In stating that it did not intend to challenge FFC's proposed database, the Antitrust Division emphasized the following points: 1) participation in the database would be entirely voluntary; 2) factories would not have access to other factories' wage and hour information except in an aggregated form; 3) outside counsel would be present at all FFC board meetings, to assure that there are no coordinated decisions regarding whether members would use a particular factory; and 4) there is very little relationship between the price of labor and the ultimate retail price of clothing (typically less than 3% of the price for clothing made in the U.S., and 0.5% for clothing made overseas) and, therefore, there would be little or no effect on consumer prices of the clothing.

The information-gathering program approved by the Antitrust Division appears, on its face, to be significantly different from the DSP, which is designed to formally approve certain factories and require that participants purchase from those factories. The key difference is that under the DSP, while no store or university is required to participate, participants would be required to source a significant portion of their merchandise from approved factories. Thus, individual sourcing choices would be taken away from the participating school, or at least substantially minimized. The Antitrust Division emphasis that there would be no coordinated purchasing decisions in the FFC program appears to be quite noteworthy in this regard.

The WRC has utilized a very good antitrust lawyer to review the DSP program. That attorney, Donald Baker, has concluded that the program will comply with antitrust requirements, and his view deserves to be carefully considered. Nonetheless, in his several opinion letters to the WRC on this topic, Mr. Baker makes a number of comments that justify caution in moving forward.

For example, Mr. Baker concludes that schools participating in the program would probably not be guilty of "boycotting" factories that are not approved because the schools do not compete with each other in licensing distinct logos, and they do not stand to profit from the program. Neither of these suggestions appears to fully reflect the facts of the universities' role in this market, however. With many collegiate logo apparel sales now occurring over the Internet, college-owned stores often compete with other sellers of the same licensed apparel. Additionally, there is competition among potential licensees both to be authorized to manufacture licensed goods and to sell those goods. When colleges and universities are making decisions jointly about both of these issues, the potential of an illegal boycott of non-selected manufacturers (factories), as well as retailers, exists.

Some industry sources have estimated the potential price impact of DSP participation on certain university logo apparel at upwards of 30%. While the current estimate by promoters of the DSP is that retail prices will increase by only 1-6%, the initial sponsors of the DSP postulated that the program could raise the consumer price for collegiate logo apparel by 10-12%. This does not appear consistent with the opinions that labor costs are at most 3% of the price of these products, or that the program does not have any type of "profit-maximizing" objective. It is very important that DSP participants have a better sense of the price-increasing potential of the program.

Interestingly, Mr. Baker concludes that, while a Department of Justice antitrust investigation of the DSP may well occur, such an investigation is unlikely to lead to an enforcement action. Mr. Baker appears to base this conclusion largely on his assumption that there will be no economic profit as a result of the program. It is not clear that this assumption accurately represents the realities of the collegiate apparel market. In this market, licensing agents make money, many college stores make money, corporations operating college stores make money, and many collegiate licensees make money. The authorization of fewer approved factories and fewer licensed retailers would each appear to have the potential to result in increased profitability for those who are designated to participate.

Mr. Baker understands the potential risks if he is wrong in his conclusion that colleges and universities are not competitors in the licensing function, or if, for other reasons, factories and licensees are hurt by the program. To address this possibility, he suggests special caution in recordkeeping, as well as training campus officials about recordkeeping, and avoiding agreements or understandings among universities on the economic terms of their licenses. This is good advice, but appears difficult to implement at the hundreds of schools that might be involved in the DSP, and perhaps even unrealistic in that there are only a few prominent licensing agencies that negotiate these licenses, resulting in a measure of commonality among universities in the economic terms of the licenses they utilize.

Mr. Baker also makes several suggestions that should make observers of the DSP cautious. For example, he suggests that all licenses contain a compulsory arbitration clause and a requirement that the loser pay all litigation costs as ways to discourage lawsuits from non-designated licensees or manufacturers. He suggests that antitrust liability might also be minimized by making all decisions "transparent;" that is, fully and publicly explaining why a factory might not be acceptable. This is an interesting recommendation, but could tend to create its own problems—such transparent decisions must be based on the most accurate information, so that the decisions themselves do not result in "trade libel" claims by disappointed factories.

Based on our review of the DSP, we have determined that certain antitrust and other legal issues remain outstanding, and these require careful thought by colleges and universities and the stores that serve them before they decide to participate. We are pleased to learn that the WRC has recently decided to seek a Business Review Letter from the Antitrust Division of the Department of Justice. Such an approach has been helpful to the FLA and the FFC in moving forward in their programs, and a letter from the Justice Department expressing an opinion would certainly give comfort to colleges and universities contemplating participation. Because the program cannot proceed before the Justice Department responds to the request for its opinion, and the Justice Department itself may request additional changes in the program, it is premature to reach a formal conclusion about the legality of the DSP. It is likely to take at least six months after the request is submitted for the Justice Department to issue its letter.

It is not necessarily a satisfactory answer to a school or a college store to say that an antitrust lawsuit is unlikely to succeed. Such suits are extraordinarily expensive to defend, time consuming and risky. Notwithstanding their charitable nature and lack of profit-maximizing goals, non-profit schools have not always succeeded in antitrust litigation against them, such as the challenge to the coordinated efforts of Ivy League universities to agree on student financial aid, *U.S. v. Brown University, et al.*, 5 F.3d 658 (3d Cir. 1993), or the challenge to the television rights packages negotiated by the NCAA, *NCAA v. Board of Regents of the Univ. of Oklahoma, et al.*, 468 U.S. 85 (1984). For all of these reasons, we support the decision of the WRC to seek a Business Review Letter from the Department of Justice prior to asking universities and their stores to reach final agreements to participate in the DSP.

Conclusion

The points made in this memorandum are not conclusive, and the discussion on this topic will continue. However, as outlined above, colleges and universities considering the DSP proposal, along with the stores serving these institutions, must consider not only the ideals the DSP seeks to attain, but also the realities of the role schools and their stores play in the business of collegiate apparel, and the legal obligations these institutions must meet. Because of its decision to seek a Business Review Letter, the DSP may not be implemented until that letter is actually obtained from the Justice Department. This process will take many months. We believe it is wise for schools to withhold committing to the DSP at least until a positive letter from the Justice Department is obtained. It is quite likely that additional modifications will be required, and it would be an empty gesture to agree to the program at this time. In the meantime, we hope that this memorandum has provided points for consideration by all parties. NACS will continue to serve as a resource for its members as this discussion continues.

Additional Information

The Fair Factories Clearinghouse (FFC) is a non-profit organization dedicated to supporting workplace compliance through the sharing of factory audit information. Its goal is to provide cost-effective, web-based information to facilitate the ability of buyers to make informed sourcing decisions.

The Fair Labor Association (FLA) is a multi-stakeholder coalition of companies, universities and NGOs committed to a rigorous program of workplace standards implementation, monitoring and remediation. The FLA favors a different approach to increasing manufacturer compliance with university codes of conduct; an approach that focuses on capacity building and education, and which involves manufacturers in its processes.

United Students Against Sweatshops (USAS) is an international student movement of campuses and individual students fighting for sweatshop free labor conditions and workers' rights. USAS members believe that university standards should be brought in line with those of its students who demand that their school's logo is emblazoned on clothing made in decent working conditions.

The Workers Rights Consortium (WRC) is a non-profit organization created by university and college administrations, students and labor rights experts. Its purpose is to assist in the enforcement of university codes of conduct adopted by schools to ensure the protection of the rights of those workers manufacturing university logo apparel.

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Both the WRC and the FLA have extensive information about the DSP available on their websites. You can find out more by going to the website addresses linked below:

<http://www.workersrights.org/dsp.asp>

<http://www.fairlabor.org/all/colleges/index.html>

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