

Pilot project option 1: independent verification

End report by Fair Wear Foundation

This report offers an overview of the activities and results of the pilot project 'third party verification in the textile supply chain of Fairtrade-certified cotton' (Option 1 of FLO's options based approach in textiles). Hereafter the project will be referred to as 'the pilot'.

The pilot was led by Max Havelaar Foundation Switzerland under guidance by Fairtrade International (FLO). The pilot was carried out by Fair Wear Foundation (FWF). ¹ In addition the pilot was supported by Stichting Max Havelaar Netherlands. ²

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¹ For the rationale why this project was carried out with the FWF see discussion paper dated 24 February prepared for the Utrecht Stakeholder Forum on 4/5 March 2010.

² For the agreement between the mentioned parties see Memorandum of Understanding (annex A). For a description of the pilot see the project description (annex B).

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1. Purpose of the pilot

The pilot set out to explore how an independent verification approach can be applied on other activities in the individual stages of the textile chain (ginning, spinning, knitting/weaving, dyeing and printing).

The following pilot objectives were agreed between FLO and FWF:

- To explore to what extent working with third party verification can contribute to measurably improving the working and living conditions along the textile supply chain for Fairtrade certified cotton.
- To explore how the verification approach can be applied further up the supply chain (in addition to CMT, whereon FWF presently focuses; ginning, spinning, knitting/weaving, dyeing, printing).
- To investigate whether and how Fairtrade elements can be added in the individual stages of the textile chain (ginning, spinning, knitting/weaving, dyeing, printing, cut-make-trim) and how a verification approach could deliver on this.
- To evaluate whether working with a third party – for example the Fair Wear Foundation (FWF) – creates a value added for both sides and in particular constitutes a cost-effective way towards achieving the overall goal of measurably improving working and living conditions along the textile supply chain for Fairtrade certified cotton.
- For FLO: to learn about the FWF verification approach and methodology
For FWF: to learn about the FLO certification approach and methodology and to work towards development of a verification approach that covers the entire supply chain.

The project researched existing / new supply chains which are using Fairtrade-certified cotton of three companies which already are members of Fair Wear Foundation and are licensees of a labelling initiative that is a member of FLO.

2. Summary of activities

This chapter summarizes the main activities that were part of this pilot. The results from activities with regard to individual companies are discussed under chapter 3.

2.1. Recruitment of participating companies

Between October 2010 and March 2011 FWF and the participating labelling initiatives contacted 10 companies that were at that time (or considering to start) working with Fairtrade certified cotton.

Switcher SA (hereafter: Switcher) was the first company to agree to participate in the pilot and to contribute to it financially. Switcher produces its garments mostly in India. It was the first company to work with Fairtrade certified cotton and also the first Swiss company to become member of FWF (Switcher joined FWF per December 2006). Switcher works with Max Havelaar Foundation Switzerland.

Nudie Jeans Co (hereafter: Nudie Jeans) was the second company to agree to participate in the pilot and to contribute to it financially. Nudie Jeans produces mostly in

Italy and Portugal. In 2011 the company decided to start working with an Indian supplier for t-shirts made of Fairtrade certified cotton. Nudie joined FWF per November 2009.

Charlie + Mary was the third company to agree to participate in the pilot. Charlie + Mary is a small fashion label and contributed in this pilot through 'Meet your scarf', a project that was initiated by Schone Kleren Campagne (Clean Clothes Campaign Netherlands), Stichting Max Havelaar Netherlands and FWF. The Meet Your Scarf-project was set up to demonstrate that it is possible to develop a fashionable item which does not just meet international labour standards at a single production stage in its value chain, but covers all stages of production. Charlie + Mary produces all its products in India and will start using Fairtrade organic certified cotton in 2011. Charlie + Mary is a member of Clean & Unique through which they are a collective member of Fair Wear Foundation.³ In 2011, Clean & Unique has become one of Max Havelaar Netherlands' licensees, allowing the use of the Fairtrade mark to its members.

The other seven companies that were approached included six FWF member companies and one non-FWF member company that already worked with Fairtrade certified cotton. All these companies decided not to participate in the pilot. Key factors in their decisions were the following:

- Financial contribution to the pilot was not considered feasible for the companies;
- Insufficient added value expected from the pilot as the Fairtrade label could already be used by those companies producing with Fairtrade cotton.

2.2. Factory audits

Between April and December 2011, most operators in the supply chains for Fairtrade certified cotton products of the participating companies were audited. As all these factories were based in India, all factories were audited by FWFs local audit team in India.⁴

FWFs audit team in India consists of the following persons:

- Dr. Joseph, Audit Team Supervisor and OHS Inspector
- Dr. Krishnamurthy, Worker Interviewer
- Ms. Rituparna Majumdar, Worker Interviewer
- Mr. Shivakumar, Documents Inspector

The off-site worker interviews that are part of FWFs auditing methodology were carried out by the Tiripur-based NGO Social Awareness and Voluntary Education (SAVE).

The audit process at some of the operators of Switcher was observed by:

- Mr. Bernhard Herold, Head Quality and International Cooperation and Member of the Executive Committee, Max Havelaar Foundation, Switzerland
- Ms. Rossitza Krueger, Textile Policy Manager, Fairtrade Labelling Organizations International, Germany

³ The Clean & Unique Association was founded in 2008 and signed an agreement with Fair Wear Foundation (FWF) the same year as a collective member. The objective of Clean & Unique Association is to make it easier for small upcoming fashion companies and designers to make fairly produced and environmentally friendly clothing and accessories.

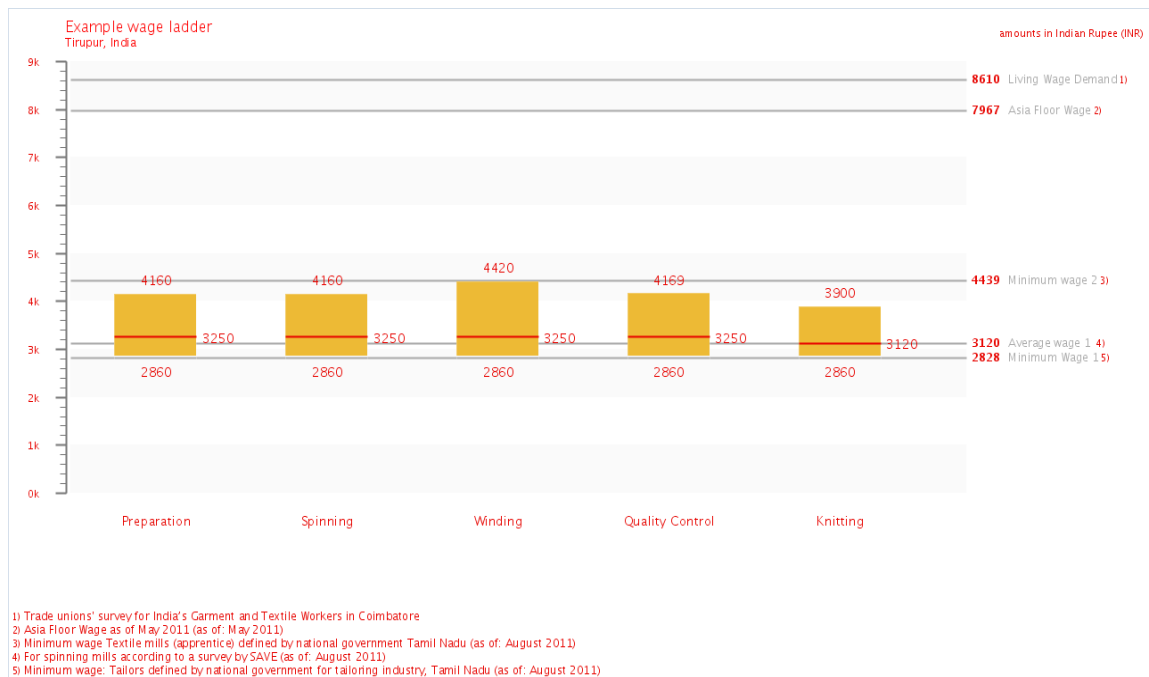
⁴ For a detailed description of FWFs audit methodology, see FWFs audit manual: see www.fairwear.org

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Each FWF audit report includes at least one wage ladder. The ladder graphically shows how paid wages at a specific factory relate to several benchmarks in a specific country. These benchmarks contain both “real” figures, like the international poverty line, minimum wage and best practices among garment factories, as well as calculated figures as to what a living wage would be for the country (or region) in question. These calculations are made by government bodies, trade unions and/or NGOs.

The Wage Ladder shows regular wages (for a normal, fulltime working week) as well as regular wages plus overtime payments and benefits. In the graph, information is given for several categories of workers (sewing, cutting, ironing, packaging, storage, quality control). For each category the lowest wage, the highest wage and the mode are shown.⁵

Example wage ladder:



2.3. Complaints procedure

In line with its standard requirements for member companies, FWF required of the participating companies that they inform suppliers (all operators at the above mentioned stages in the supply chain) about the complaints procedure. In practice this is done by providing the supplier with a local translation of FWFs information sheet for workers which explains FWFs Code of Labour Practices and contains the contact details of FWFs local complaints handler. This document must be posted in the factory in a place easily accessible to workers. It is also handed out during factory audits by FWFs audit team.⁶

FWF established an additional complaints handling hotline in Tirupur due to the high risk of forced labour issues in South India. SAVE⁷ is cooperating with FWF to handle the

⁵ Further information on the wage ladder: see FWF policy document on Payment of Living Wages

⁶ For a description of FWFs complaints procedure: see www.fairwear.org

⁷ Social Awareness and Voluntary Education (SAVE) is a Non-Government Organization promoted in the year 1993, as a response to the increasing child labour practices but

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hotline. Besides receiving phone calls, SAVE also conducts regular workers interviews in the region to enhance communication with workers. No complaints regarding the audited factories in this pilot were reported up to now.

2.4. Brand performance checks

The brand performance check is a tool for FWF to verify that companies implement FWFs management system requirements for effective implementation of the Code of Labour Practices.⁸

FWF believes that both buyers and suppliers share responsibilities in improving working conditions. As issues regarding wages and working hours can be influenced by the sourcing practices of buyers, information from factory audits can be used to assess the purchasing practices of a member company as part of the brand performance check.

3. Results of the pilot

3.1. Switcher SA

3.1.1. Factory audits

Audit process

Three facilities of Prem Durai Exports were audited between 4th April and 8th April 2011:

- Surpass (Knitting) (FLO ID 4852)
- Classic Spinning Mills (Spinning) (FLO ID 4851)
- Prem Durai Exports Unit II (also called PDEII, Cut-Make-Trim) (FLO ID 4854)

Two facilities of Prem Durai Exports were audited between 10th August and 11th August 2011:

- Prem Durai Unit 3 (Cut-Make-Trim)
- Printing and Embroidery Unit

Two units owned by this company have been audited by FWF in the past 6 years. The first audit was conducted in March 2005 – the CMT unit, Prem Durai Exports II, was audited at that time – this audit being conducted on behalf of ISCOM – the organisation that preceded FWF in Switzerland.

In March 2008 a verification audit of PV Apparels at the Nethaji Apparel Park in Eetiveerampalayam, New Tirupur was also conducted. The CMT units of this company are constantly audited by other brands and buyers. In recent years JC Penney, Wal-Mart and Target audited the PDE II CMT unit. The reports of these audits were shared with the auditors. The above mentioned five facilities were audited by Fairtrade Labelling Organisation. In September 2010 the entire supply chain of the Prem Durai Exports

eventually involved in the empowerment of women and comprehensive development of the textile and garment industry workers. SAVE organises women's rights awareness campaigns, works with companies to build violence prevention capacity, and lobbies against forced labour. See <http://www.savengo.org/>

⁸ FWFs management system requirements are specified in the FWF Charter: see www.fairwear.org

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Private Limited that is involved in the production of Fairtrade Cotton t-shirts was audited by SGS, after which the data was entered into the Sedex system. The Dyeing Unit of Prem Durai (FLO ID 4853) was not audited to date as it had not yet started functioning after the ban on dyeing has been imposed in the Tirupur region.

The reports from the factory audits at Prem Durai are enclosed as annex C.

On 6-7 December 2011 the facilities of the ginning mill Shree Gurukrupa Cotton Industries) were audited. This is an independent company which has been conducting ginning operations as a subcontractor for Suminter India Organics Pvt. Ltd. (FLO-ID 19484), from which Prem Durai Exports sources Fairtrade certified cotton since 1998⁹.

Audit results

The corrective action plans resulting from the factory audits are part of the reports in annex C. Below the most noteworthy conclusions are summarized.

Findings from the factory audits regarding the role of Switcher as a buyer:

- Whereas minimum wages have been paid to workers in Classic spinning mill and Prem Unit II, the wage level of the units has not reached the level of living wages defined by FWF key local stakeholders.

Findings from the factory audits regarding all audited operators at Prem Durai:

- The FWF Code of Labour Practices has been displayed in English. The Tamil version has been provided by Switcher. However, the Tamil version of this code was not displayed in Classic Spinning Mill and Surpass.
- There are five committees - works, grievance, anti-sexual harassment, canteen and OHS. However, a number of workers are not aware of the committees, even though the list and photographs of the committee members are posted at the entrance of the factory. Workers representatives in the committees are not elected by workers. In Surpass and PDE II, some workers were not aware of the mechanism by which they could represent their concerns to the management, particularly regarding their wages.
- Workers are not aware of their wage calculations including their bonus, deductions for Employees' State Insurance and Provident Fund.
- Overtime hours were not properly documented.
- There was evidence of excessive working hours (12 hours per day) on certain days. According to information later received from Switcher, this happens only due to urgent shipments and not on a regular basis. Various improvements were needed with regard to health and safety.

Findings from the audits regarding specific production stages of Prem Durai:

- At the PDE II those workers living in hostels were permitted to leave the premises of the hostel once a month for shopping accompanied by the warden.

⁹ Switcher's direct supplier Prem buys cotton in bulk portions. The last order placement for ginned cotton Suminter took place in 2010. Since Prem was not certain about continuing the relationship with Suminter into 2011-2012, no further orders were placed. For this reason, Switcher and Nudie Jeans did not actively monitor working conditions at the ginning stage.

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They should always be accompanied by warden if they wish to go out. In general they did not leave the hostel. Workers did not complain about the system and said that it is for the safety of them.

- Wages in Surpass knitting are lower than minimum wage. In addition there was a discrepancy between the payments made to some of the workers and stipulations in workers' appointment orders.¹⁰
- The workers in the knitting department are given a copy of the Appointment Letter but they are not aware of this document being their labour contract.
- Though there are large numbers of workers from Northern India at Prem Durai Unit III, none of them are provided with an appointment letter in their native language.
- At the ginning mill it was found that most workers were not given wage slips and that compulsory excessive overtime occurred-

Follow up on corrective action plans:

In June 2011 FWF received an update from Switcher with regard to the process of implementing the corrective action plan resulting from the factory audits carried out in April. The reported improvements could not yet be verified by FWF by means of a factory audit within the timeframe of the pilot project.

Below a summary of the reported improvements by Switcher:

- Code of Labour Practices in Tamil language with the contact details of complaints handler has been posted in all workplaces at Prem Durai.
- The factory has been conducting a training programme for workers to inform them about the workers committees, their function, social dialogue and labour rights. Trainings were given to migrant workers in their own languages and now management had selected employees from other states as a committee member. A description of the grievance handling procedure was posted in the notice board along with the name of the grievance handling manager.
- Prem Durai stated that it would increase worker wages each year on an incremental basis.
- Payments for overtime has been specified on workers' wage slips.
- Currently appointment letters are printed in English, Tamil and Hindi and given to the workers.
- On appointment letters, it is mentioned that accommodation deductions will be withdrawn from workers wages.
- Various measures were reportedly taken regarding occupational health and safety in workplaces and dormitories. Improvements included providing rubber mats for standing workers, appointment of a female NGO representative and a

¹⁰ During the process of writing this report, Switcher and Prem Durai stated that this is the result of deductions for providing short term accommodation to workers from North India. According to Switcher and Prem Durai, it is especially difficult for these migrant to find accommodation in Tiripur. FWF notes that this practice is legal in India, but that rent deductions from salaries should be documented. The audit team did not find such records during the audit confirming this practice. Management of Prem Durai did not mention this practice at the time of the audit.

nurse as a member of the anti sexual harassment committee, first aid trainings for more workers and improvements in food quality and hygiene.

- Appointment letters are being issued at the time of revision of wages of the workers. In addition workers are made aware of the importance of safeguarding their appointment letter.
- On a few important issues that were included in the corrective action plan from the factory audits, no progress was reported but management reaffirmed the following:
- Workers are not allowed to leave the hostel without the company of warden due to security reasons as the management is responsible for the safety of the dormitory inmates.
- Overtime was properly documented.

3.1.2. Complaints

No complaints were filed by workers or other parties regarding the implementation of the Code of Labour Practices in the factories where clothing was produced for Switcher.

3.1.3. Performance check

FWF carried out a brand performance check at the headquarters of Switcher on 16th August 2010. The report from the performance check (annex F) can be found on www.fairwear.org. Below the conclusions that are most noteworthy in the context of the pilot (and the factories that were audited as part of the pilot) are summarized in relation to FWFs management system requirements for affiliate members:

Sourcing practices support effective implementation of the Code of Labour Practices

Switcher's sustainability agreement with suppliers includes provisions regarding the implementation FWF's Code of Labour Practices. About 67% of Switcher's turnover is produced at factories with long term relationships.

Of all suppliers in its 2010 supplier register Switcher maintains a business relation for more than 5 years with 9 suppliers, which represent 70% of its total purchasing volume. This enables the company to effectively request improvements in working conditions.

On the level of individual suppliers the order volume of Switcher accounts for maximum 30% of the total production volume of a supplier.

Switcher sources primarily from its business partner Prem Durai Group. Prem Durai Group is an investor of Switcher. 47.58% of Switcher's volume was produced at Prem Durai. The fact that Switcher and Prem Durai have a strong mutual relationship offers much potential for effective implementation of FWFs CoLP: the long term relationship offers a strong incentive to commit to the improvement process.

Working conditions and the willingness of suppliers to cooperate on improvements are important criteria in the selection of new suppliers and the continuation of business relationships

In the process of selecting new suppliers Switcher production staff visits a factory, assesses its current compliance status and informs the factory about FWF's membership. Switcher requires suppliers to cooperate with FWF's independent verification activities.

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Switcher has relocated some of its production to Portugal. As a result, 12.5% of its total volume is now produced in low risk countries. FWF believes that in these countries the presence and proper functioning of institutions (trade unions, works councils, labour legislation and labour inspection) can guarantee compliance with international labour standards.¹¹

Switcher believes that advantages exist in working with vertically integrated factories as the company requires traceability of each product and selects factories on this basis.

Delivery times and the pricing policy do not lead to excessive overtime and contribute to a systematic approach towards a living wage for workers

Switcher supports the principle of paying living wage to workers. In practice living wages is not discussed by Switcher staff during negotiation with suppliers. Legal minimum wage is the basic requirement for Switcher. As much as Switcher is willing to pay an extra amount to ensure living wage, the company finds it difficult to monitor if the payment goes directly into the pockets of workers. At the moment most suppliers are not at the level of Asian Floor Wage.

Excessive overtime work was found in a Chinese supplier during both audits carried out by FWF in January 2010 and the audits carried out on behalf of Switcher in May 2009. Minimum wage was paid at all Switcher suppliers audited by FWF. Overtime work was not always paid according to local legal requirements. FWF cannot conclude that Switcher has made sufficient effort to support suppliers in reducing excessive overtime.

The corrective action plans resulting from conducted audits are systematically agreed upon, followed up and reported on

Switcher has actively followed up on all corrective action plans by email/phone/factory visits at a minimum interval of one year. This does not mean that all improvements were fully realised, but that steps are currently being taken.

In general Switcher relies on its supplier to monitor working conditions in previous stages of the supply chain.

The percentage of the member's turnover that has been monitored corresponds to the required percentage based on the duration of FWF affiliation

Due to the high risk of forced labour in South India and the pilot with FLO, FWF suggested Switcher to focus on its main supplier and audit other processes of Fairtrade cotton under the FWF standards.

Up to the date of the performance check, Switcher had audited 52.78% of its total turnover with the local audit team of FWF within the past years. 5.75% of its volume was produced in low risk countries (Portugal). Herewith the monitoring system of Switcher covers 58.53% of its total purchasing volume. This percentage is below the monitoring requirement of FWF based on the duration of Switcher's membership (90% after 3 years of membership). Switcher decided that it is more cost effective for the company to focus on its main suppliers. Switcher plans to further increase the order volume at its main Indian supplier, which would increase the monitoring percentage by the end of 2011.

¹¹ For FWFs low-risk policy see: http://fairwear.org/images/2011-09/low_risk_policy_fw_f_-_mar_2009.pdf

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The affiliate responds adequately to complaints submitted by workers

Switcher has a designated person to handle complaints of workers.

No complaints have been submitted by workers in 2011.

Switcher has a systematic approach to check that the code of labour practices is posted at CMT production sites in all production countries for. As the company depends on CMT suppliers to check this at operators in other stages in the chain, the CoLP is often not posted at these operating stages.

Corrective Action Plans are executed and have led to verifiable improvements

Switcher actively responded to FWF's strategy against Sumangali Scheme in South India.

Prem Group reported improvements based on the corrective action plans resulting from the audits conducted by FWF team in April. These could not yet be verified within the scope of the pilot as FWF did not yet carry out another factory audit to verify improvements.

Conclusions specific to the pilot

3.8% of Switcher's cotton articles are sold under the Fairtrade Certified Cotton label.

For new suppliers processing Fairtrade cotton, Switcher only chooses Fairtrade certified factories instead of persuading existing suppliers to start working with Fairtrade certified cotton. In that case, Switcher relies on the CMT suppliers to make sure materials and accessories are sourced from factories meeting social standards.

For factories processing Fairtrade cotton, the FLO IDs of all operators in the supply chain needs to be submitted to Switcher prior to the first order.

3.2. Nudie Jeans

3.2.1. Factory audits

Audit process

Four facilities of the Armstrong Group were audited between 29th June 2011 and 2nd July 2011:

- Armstrong Spinning Mills Private Limited (spinning of cotton yarns) FLO ID: 18815
- Armstrong Process Division (dyeing knitted material into colours) FLO ID: 19026
- Armstrong Knitting Mills (bleaching, CMT, dyeing, embroidering, knitting, printing and weaving) FLO ID: 18753
- Armstrong Knitting Mills Unit II (CMT) FLO ID: 23532

The CMT unit (Armstrong Knitting Mills) of the company has been audited by FWF once in the past 6 years. The first audit was conducted in March 2005 – the audit was conducted only for the main unit at the headquarters on behalf of ISCOM.

The company and its units are audited by other brands and buyers. In November 2010 the entire supply chain of the Armstrong Knitting Mills that is involved in the production of Fairtrade Cotton t-shirts was certified by FLO.

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On 6-7 December 2011 the facilities of the ginning mill (Suminter India Organics Pvt. Ltd. / Shree Gurukrupa Cotton Industries) were audited. This is an independent company which has been conducting ginning operations for Prem Durai (supplier of Switcher) and Armstrong (supplier of Nudie Jeans).

The reports from the factory audits at Armstrong are enclosed as annex E.

Audit results

The corrective action plans resulting from the factory audits are part of the reports in annex E. Below the most noteworthy conclusions are summarized:

Findings from the factory audits regarding the role of Nudie Jeans as a buyer:

- Whereas minimum wages have been paid to workers in the Armstrong facilities, the wage level of the units have not reached the level of living wages defined by consulted local stakeholders.

Findings from the factory audits regarding all audited operators of Armstrong:

- Armstrong Group had acquired the Tamil version of workers information sheet from FWF directly. The CoLP is not posted in Hindi - a language spoken by many workers especially in the CMT Units.
- The legally required committees are in place (works committee, health and safety committee, committee for grievances and prevention of sexual harassment but none of the workers were aware of these.
- Various improvements were needed with regard to health and safety.

Findings from the audits regarding specific production stages of Armstrong:

- At the spinning mill those workers living in hostels were not permitted to leave the factory premises unless accompanied by the warden. Both workers and management believe that it is because of personal security reasons. FWF commented that the factory should give full permission to workers to leave the factory and the hostel after working hour. The factory manager has responded to the issue. Due to cultural differences, FWF and the member company have decided to give this issue room for further discussion.
- At the spinning mill the age proof documents of a number of workers was not found in their personal files. The juvenile workers are on the shop floor are making more working hours than legally allowed.
- The physical quality of the drinking water is below the recommended standards in the process division.
- At the ginning operator it was found that most workers were not given wage slips and that compulsory excessive overtime occurred.

Follow up on corrective action plans

The reports of the audits at Armstrong were sent to Nudie Jeans on 26th August. The reports were discussed in detail between FWF and the purchasing manager of Nudie Jeans on 13th September.

Nudie Jeans made follow up visits at all production sites of Armstrong in October and December 2011. The lead auditor of FWFs local audit team in India accompanied staff of Nudie Jeans during these visits. Nudie Jeans made reports of discussions with Armstrong, which were shared with FWF.

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Among other issues, the following improvements were realised according to the companies:

- Documentation on juvenile workers was developed. The factory cut back the amount of night shifts for juvenile workers and chose to recruit less juvenile workers.
- Most of the points regarding health and safety were followed up on.
- Workers received basic training about their statutory rights regarding collective bargaining.
- Wages were paid directly to workers instead of to their parents, and workers were provided with pay slips.
- Drinking water was tested and found potable.

The above mentioned improvements could be verified by FWF during the limited timeframe of the pilot project. A factory audit to verify improvements will be carried out in 2013.

3.2.2. Complaints

No complaints were filed by workers or other parties regarding the implementation of the Code of Labour Practices in the factories where clothing was produced for Nudie Jeans.

3.2.3. Performance check

FWF carried out a brand performance check at the headquarters of Nudie Jeans on April 19th 2011. In addition to the regular interviews that are part of the performance check FWF conducted an interview with the purchasing manager of Nudie Jeans regarding issues pertaining to the pilot. The report from the performance check (annex F) can be found on www.fairwear.org. Below the conclusions that are most noteworthy in context of the pilot (and the factories that were audited as part of the pilot) are summarized in relation the relevant FWF management system requirement for affiliate members. To offer a more robust overview of the extent to which Nudie Jeans meets FWFs requirements, key findings resulting from the pilot have been taken into account here as well.

Sourcing practices support effective implementation of the Code of Labour Practices

Nudie Jeans has no written sourcing policy or strategy. However, the company has an outspoken policy to focus production in European low risk countries. This is also a major reason why almost all production has been in Italy and Portugal, with only a minor part being done in Turkey and India. One of the major reasons for this strategy is to minimise risk of labour rights violations in the supply chain.

In general Nudie Jeans regards the ability of suppliers to assure good working conditions to be at the core of its sourcing strategy. The company's expansion to high risk countries is made under the premise that only suppliers with a commitment to social and environmental standards are accepted.

Working conditions and the willingness of suppliers to cooperate on improvements are important criteria in the selection of new suppliers and the continuation of business relationships

The willingness of suppliers to cooperate on improvements of working conditions is a prerequisite in the selection of new suppliers and the continuation of business relationships. Potential new suppliers are visited to check basic working conditions including working times, payment and trade union presence. All potential new suppliers are informed about FWF before sampling starts. Nudie requires suppliers to cooperate in FWF's independent verification activities.

There is no system to evaluate or grade suppliers regarding performance on working conditions. There is also no formalised incentive system to reward suppliers for realised improvements of working conditions.

Delivery times and the pricing policy do not lead to excessive overtime and contribute to a systematic approach towards a living wage for workers

There has been no fixed system to negotiate prices with suppliers. In the beginning, prices were set according to the quotes from the factories. Now the jeans are produced to match the three different price categories of Nudie Jeans. The suppliers are sometimes asked to help come up with ways of producing the different jeans to meet the price categories. The wage component of the price is not separated during price negotiations.

There is an understanding within the company that lead times, late changes in design or orders can contribute to, for example, problems for suppliers to keep working times within legal limits. There is an ambition to not change orders and approve samples within three days, but this has not always been possible due to staff shortage. The general feedback from suppliers is that they need more orders to keep staff instead of being pressured to work overtime because of the amounts of orders.

The percentage of the member's turnover that has been audited corresponds to the required percentage based on the duration of FWF affiliation

The percentage of Nudie Jeans' turnover that has been audited corresponds to the required percentage based on the duration of FWF affiliation (60% after two years of FWF membership).

The corrective action plans resulting from conducted audits are systematically agreed upon, followed up and reported on

During 2010 the low risk policy of FWF was implemented at all suppliers in Portugal and Italy. All suppliers were visited by staff of Nudie Jeans, the FWF Code of Labour Practices was signed by all suppliers in Portugal and Italy and questionnaires filled in. Information sheets for workers were posted and country specific issues were followed up. At the production locations in Turkey (high risk country), no factory audits were carried out.

In January 2011, the CSR responsible at Nudie Jeans visited ten production sites in Italy. The purpose was not to do full social audits, but to collect information on certifications and find out suppliers knowledge and awareness on CSR issues. The visits included interviews with management and workers as well as a visual inspection of the facilities. No formal corrective action plans resulted from these factory visits.

The affiliate responds adequately to complaints submitted by workers

Nudie Jeans has a designated person to handle complaints of workers.

No complaints have been submitted by workers in 2011.

Nudie Jeans has no systematic approach to check that the code of labour practices is posted at production sites in all production countries. As a result Nudie Jeans could not yet ensure that FWFs CoLP is posted in all factories where it places orders.

Corrective Action Plans are executed and have led to verifiable improvements

Less than 5% of the Nudie Jeans sold have been treated with abrasive blasting. Abrasive blasting of denim using abrasive material containing free silica has been shown to cause silicosis, a deadly lung disease. Due to the seriousness of the consequences of using abrasive blasting, the difficulty to secure safety and FWF not being able to verify that abrasive blasting is done in a safe way, FWF adopted a policy to immediately ban all abrasive blasting using abrasive material containing free silica and to require a phase out of all abrasive blasting. The time scale for this phase out would depend on the individual company's ability to assure that it is done in a safe way. During 2010, Nudie Jeans focused their effort in this area to mitigate the risk at those suppliers doing abrasive blasting.

Update March 2012: During 2011 Nudie Jeans did not produce sandblasted products. This led to an official note by the company in December 2011 Nudie Jeans no longer accepts sandblasted products from its suppliers.

Conclusions specific to the pilot

During 2011 Nudie Jeans expanded production to India on the basis of a decision to include Fairtrade cotton items in its collection. The Indian supplier was selected on the basis of its price quote and its existing Fairtrade certification.

3.3. Charlie + Mary

3.3.1. Factory audits

The audit process at the operators in the supply chain for the Meet Your Scarf Project could not be completed as planned. The audit at The Creative Texture (the fabric supplier) was terminated before the audit team could discuss its conclusions with factory management. Because of this, the audit at Kishor Exports was cancelled by factory management who indicated they did not want to jeopardise their business relationship with the fabric supplier.

The auditing of the operators had to be carried out relatively late as the lead supplier (Kishor Exports, FLO ID: 21723, CMT) informed Charlie + Mary and FWF about the other operators in the supply chain only after the order for the Meet Your Scarf Project had been placed in June 2011. After the order was placed the supplier of the fabric that had previously been selected was replaced by another supplier.

In August factory audits were scheduled at Kishor Exports and The Creative Texture (FLO ID 26376). During the months preceding these audits FWF discussed its audit methodology with Charlie + Mary. In addition FWFs audit team supervisor explained the audit process with factory management as part of the audit announcement.

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The audits could not be completed during the project as the factory owner of The Creative Texture felt that he had insufficiently been informed about the offsite workers interviews.¹²

After data collection from all information sources FWFs audit team and factory management entered into the exit meeting at The Creative Texture. During this meeting it was discussed that the audit results would be shared with all project partners in the pilot including Fairtrade International. The audit process came to a standstill as factory management refused to cooperate further in the audit. The factory management stated that it did not want the results of the audit to be shared with FLO.

As a result the audit findings could not be completed and the order of fabric for the Meet Your Scarf Project was cancelled by The Creative Texture.

After the audit process FWF, Charlie + Mary and the other involved project partners made attempts to convince The Creative Texture to cooperate in finishing the audit process. It was at that stage communicated to The Creative Texture that the audit results would be shared with Fairtrade International but that it would not influence the Fairtrade certification of The Creative Texture. These attempts were not successful. From the feedback received from The Creative Texture it became evident that the factory did not accept the fact that workers interviews had been carried out by the audit team outside the factory premises. According to the factory they had not been informed about this practice beforehand of the audit.¹³

FWF concludes from the above mentioned process that The Creative Texture was reluctant to share the audit report with Fairtrade International as they feared that some of the findings might affect its Fairtrade certification.

3.3.2. Complaints

No complaints were filed by workers or other parties regarding the implementation of the Code of Labour Practices in the factories where clothing was produced for Charlie + Mary.

3.3.3. Performance check

FWF carried out a brand performance check for the Clean & Unique Association, which includes Charlie + Mary, in September 2010. The report from the performance check (annex G) can be found on www.fairwear.org. The performance check for Clean & Unique in 2011 is still to be carried out.

Below the conclusions that are most noteworthy in context of the pilot (and the factories that were audited as part of the pilot) are summarized in relation the relevant FWF management system requirement for affiliate members. To contribute to a more robust

¹² FWF generally states that its auditing methodology includes off-site interviews as one of the sources of information from workers. To ensure the security of the workers and FWFs interviewer, these interviews are not formally announced to suppliers. In retrospect the role of the off-site interviews may not have been sufficiently explained during the meetings FWF had with Charlie+Mary. Suppliers generally accept this element of FWFs audit approach when it is discussed during the exit meeting. As Charlie+Mary did not have a long term relation and limited leverage with the supplier, the off-site interviews were a reason for the supplier to dismiss the audit.

¹³ Off-site worker interviews are a standard element of FWFs audit methodology. As a part of announcing the factory audit, FWF expects the involved member company to explain that off-site interviews will be carried out.

overview of the extent to which Charlie + Mary meets FWFs requirements, key findings resulting from the pilot have been taken into account here as well:

Sourcing practices support effective implementation of the Code of Labour Practices

Performance check 2010: Charlie + Mary sourced all their clothes at one supplier in India. During 2010 this cooperation ended since the factory decided that Charlie + Mary was a too small customer for them. Charlie + Mary had visited the factory once in 2008. At the time of the performance check Charlie + Mary were looking for a new supplier.

Pilot 2011: Charlie + Mary has limited leverage at its supplier for clothing, as its order volume at its direct supplier account for approximately 1% of the total production volume of the supplier. This limits the company in its possibilities to effectively request improvements in working conditions. Though fellow Clean & Unique member Studio JUX is also producing at Kishor and intends to continue the business relationship. Together it is estimated that their order volume accounts for 1% of the total production volume of the supplier.

Working conditions and the willingness of suppliers to cooperate on improvements are important criteria in the selection of new suppliers and the continuation of business relationships

Pilot 2011: In context of the Meet Your Scarf Project, Charlie + Mary selected a supplier for a single order. The supplier was selected on the basis of price, capacity to produce the right quality, willingness to produce a relatively small order (less than 1% of factory production capacity), and Fairtrade certification.

Delivery times and the pricing policy do not lead to excessive overtime and contribute to a systematic approach towards a living wage for workers

Performance check 2010: The Clean & Unique association has no sourcing policy for all its member brands. Members are themselves responsible to make sure sourcing practices supports effective implementation of the Code of Labour Practices. Most of the member companies are too small to put pressure on their suppliers regarding prices and lead times. The biggest challenge for most of them has been finding suppliers who want to produce small orders and give their orders priority.

The percentage of the member's turnover that has been audited corresponds to the required percentage based on the duration of FWF affiliation

Performance check 2010: Charlie + Mary briefed the supplier on FWF membership and discussed social compliance with them extensively. One factory audit was scheduled by FWF at the Indian supplier to Charlie + Mary. This audit was cancelled by the factory since it ended its cooperation with Charlie + Mary. Charlie + Mary tried to cooperate with the other buyers to monitor working conditions at the supplier.

Pilot 2011: Charlie + Mary commissioned audits at the operators for CMT and fabric production as part of the Meet Your Scarf Project.

4. Conclusions regarding participating companies

This section assesses the capacity of each of the participating companies to meet the Fairtrade requirements as formulated in the project proposal.

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As a part of this FWF assessed what would be the impact of a hypothetical wage increase that would ensure payment of living wages for a regular working week. See Annex H for an explanation on how these calculations were carried out and the underlying assumptions.

FWF requested the audited operators to specify their internal cost structure, i.e. to provide a cost breakdown between material inputs and “factory minute costs”. The latter includes staff expenses (salaries, social security) but also energy, communication, repair, maintenance costs, depreciation, amortisation, rent, security, etc. (but not the factory margin). FWF also requested Switcher and Nudie Jeans to provide a cost breakdown for a specific t-shirt made with Fairtrade certified cotton.

Combining the above information with the wage benchmarks and the cost breakdown of the factories made it possible to estimate the impact that a hypothetical wage increase towards living wages would have on the pricing of an individual t-shirt. The figures are shown in Annex I and J.

As various living wage benchmarks exist, the Asia Floor Wage Campaign benchmark for India was taken as a proxy for living wages.

The impact of a wage increase on FOB price and retail price was calculated for two scenarios:

- Additional cost of the wage increase is not escalated through the supply chain
- Additional cost of the wage increase is escalated through the supply chain (this means that for expenditures such as customs, wholesale and retail maintaining the existing ratio of FOB price / expenditure is maintained).

4.1. Switcher: capacity to meet Fairtrade requirements

General implementation of FWFs management system requirements

Switcher is in the process of implementing FWF’s management system requirements. The company is able to effectively work towards improvements in working conditions where the company has sufficient leverage. The fact that Switcher has a close relationship with Prem Durai Group combined with this being a vertically integrated supplier offers substantial potential, especially as Switcher plans to further increase the order volume at this supplier.

Prem Group reported improvements based on the corrective action plans resulting from the audits conducted by the FWF team in April. These could not yet be verified within the scope of the pilot as FWF did not yet carry out another factory audit to verify improvements.

Potential to implement living wages

Switcher supports the principle of paying living wage to workers. In practice living wages is not discussed by Switcher staff during negotiation with suppliers. At the moment wages at most of its suppliers are not at the level of Asian Floor Wage.

FWF calculated for the GAIA jersey, one of the items of Switcher’s standard collection that is made of Fairtrade certified cotton, what would be the estimated impact of a hypothetical wage increase (see Annex I).

If not escalated, the FOB price would increase by 14.2% (€ 3.22 → € 3,68). As a result the retail price would increase by 3.5% (€ 13.01 → € 13.46).

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If increased manufacturing cost would be escalated further throughout the chain, the FOB price would increase by 15.6% (€ 3.22 → € 3.72). Such an increase would lead to a 14.3% increase of the retail price (€ 13.01 → € 14.87).

If increased manufacturing cost would be escalated further throughout the chain, but if the gross margin of the factory would be kept at the same level, the FOB price would increase by 14.2% (€ 3.22 → € 3.68). Escalating the costs at the wholesale and retail level after that would lead to a 13% increase of the retail price (€ 13.01 → € 14.70).

It should be noted that the share of staff costs was about 70% of the factory minute costs according to data obtained from Prem Durai. In comparable vertically integrated factories in India / Thailand this lies around 30%-40%. As a result the impact of the wage increase is relatively high, almost double in comparison to other factories.

At the time of writing this report Switcher was not sure how it would like to deal with such a cost increase if it would happen in reality. However the company did make clear that due to the current strong exchange rate of the Swiss Franc, the company needs to avoid further price increases for its customers.

4.2. Nudie Jeans: capacity to meet Fairtrade requirements

General implementation of FWF's management system requirements

Nudie Jeans is in the process of implementing FWF's management system requirements. The company has focused its sourcing to low risk countries to minimise the risk of labour rights violations. As Nudie Jeans mainly places orders at factories in low risk countries in the EU and the Mediterranean region, the company is relatively inexperienced with the process of monitoring working conditions in factories. Nudie Jeans need to improve its management system in order to be able to follow up corrective actions in a systematic way and to provide FWF with correct information regarding its suppliers. As a result of limited time that remained for follow up on corrective action plans during the pilot no improvements could be verified by FWF.

Potential to implement living wages

Whereas Nudie Jeans does not have a systematic approach to implement payment of living wages, the company has demonstrated openness to implement this issue during interviews that were part of the pilot.

FWF calculated for the Roundneck T-shirt, one of the items of Nudie's standard collection that is made of Fairtrade certified cotton, what would be the estimated impact of a hypothetical wage increase (see Annex J).

If not escalated, the FOB price would increase by 5.2% (€ 5 → € 5.26). As a result the retail price would increase by 0.9% (€ 29 → € 29.26).

If increased manufacturing cost would be escalated further throughout the chain, the FOB price would increase by 6.8% (€ 5 → € 5.34). Such an increase would lead to a 5.4% increase of the retail price (€ 29 → € 30.55).

If increased manufacturing cost would be escalated further throughout the chain, but if the gross margin of the factory would be kept at the same level, the FOB price would increase by 5.2% (€ 5 → € 5.26). Escalating the costs at the wholesale and retail level after that would lead to a 4.2% increase of the retail price (€ 29 → € 30.23).

The share of staff costs was about 40% of the factory minute costs according to data obtained from Armstrong.

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In relation to the estimated financial impact of a hypothetical wage increase at Armstrong towards Asia Floorwage, the company stated that it could imagine working with the resulting FOB price increase.

In this hypothetical case Nudie Jeans would consider to cut the cost of the packaging material for this item, which is presently relatively expensive. Alternatively, the company would possibly accept a lower margin on the product. A third possibility would be that Nudie Jeans would place orders for other items at Armstrong in order to decrease the FOB price of these products.

4.3. Charlie + Mary: capacity to meet Fairtrade requirements

General implementation of FWFs management system requirements

Charlie + Mary is at a very early stage in the process of improving working conditions. As the company had recently established a relation with its direct supplier, mutual trust between both parties may have been too new to enter into a process of continuous improvement in working conditions. As the relation with the direct supplier was maintained on the basis of the placement of a single order, no robust economic incentive for implementation of the corrective action plan existed for the supplier. As the company was accounting for roughly 1% of the total production volume of Kishor Exports, and as Charlie + Mary was not able to commit to long term order placement, its leverage to request improvements was limited.

The fact that Charlie + Mary had no previous experience with the process of monitoring working conditions in factories could partially explain that misunderstandings came to existence regarding FWFs auditing approach, which led to cancellation of the above mentioned factory audits.

As a result of the cancellation of the factory audits, the level of compliance with FWFs Code of Labour Practices could not be assessed. In addition, no information can be provided here regarding the capacity of Charlie + Mary / Project Meet Your Scarf to measurably contribute to improvements in working conditions including an increase of workers' wages.

5. Recommendations to FLO

5.1. General insights

From the perspective of FWF the following key insights were drawn from the pilot.

- Companies need to have a mature CSR policy and strong, longlasting relationships with suppliers in order to be effective in implementing CAPs.
- It has proven a challenge to convince member companies to participate in the pilot, since already today most consumers, when purchasing garments made with Fairtrade-certified cotton, assume they are actually purchasing "Fairtrade garments" where proper labour conditions are guaranteed.
- Whereas all factories had been approved suppliers by FLO, FWFs factory audits pointed out that in all production stages labour rights violations are found. To assure the credibility of the Fairtrade mark, additional measures are needed to implement labour standards at all operators along the supply chain.
- As far as the limited project period allowed for, companies could report improvements that were realised in factories. These could not be verified by

FWF during the limited timeframe of this pilot project. To allow for verification of improvements during future projects it is necessary to develop a multi-year timeframe.

- FWFs verification activities on factory level offer insight in the extent to which factory level trade unions, workers committees and grievance procedures function effectively. At one factory FWFs verification activities led to the initiation of training programs for workers to inform them about the workers committees and their function, social dialogue and labour rights. These activities prominently involved a local labour rights NGO.
- No complaints were filed by workers or other parties during the project period. This might suggest that workers in the factories that were part of the pilot project did not fully understand how FWFs complaints procedure could support them. For this reason FWF plans to start handing out business cards to workers in audited factories with further information on its complaints procedure.
- The management systems of FWF member companies generally support realisation of improvements in working conditions. FWF suggested and / or requested adaptations from individual members to further strengthen their management system.
- The participating companies stated that they expect to be able to contribute to realisation of living wages in factories on the basis of the projected impact on retail prices.
- FWF's verification approach proved to be a suitable approach to assess labour conditions further down the supply chain (beyond CMT). Many of FWFs auditors do have experience in auditing suppliers in other production stages. The major challenge is that in FWF's approach the leverage of member companies is used towards their direct suppliers. Usually member companies do not have a direct relationship with operators further down the chain. This means that the leverage of member brands most strongly affects first tier suppliers and vertically integrated suppliers. Therefore the FWF approach, strongly involving member companies, is estimated to be less effective when the supply chain consists of various independent operators that the member company has no direct contact with.

5.2. Added value of independent verification for strengthening the Fairtrade mark

- The challenge ahead is to implement Fairtrade elements at all operating stages of the textile chain, and to simultaneously have a comprehensive approach that addresses relations (and transactions) between operators at the different stages. To strengthen the momentum for further efforts to implement Fairtrade requirements in their supply chains, a comprehensive approach is needed that scrutinises purchasing practices of brand companies and engages factories in long term improvement processes.
- Observing the overarching objective to measurably improving the working and living conditions along the textile supply chain for Fairtrade certified cotton, independent verification offers much added value that complements FLOs existing approach. Particularly with regard to the process of implementing living wages in all operating stages of garment production, independent verification

End report FLO pilot option 1: independent verification

would strengthen the existing model. Credible implementation of living wages does not only require an ongoing assessment of all operators in the supply chain. Even more importantly, independent verification of the purchasing practices of the brand company and public reporting is needed to ensure that efforts and results by companies are sufficient.

FWF believes that it is necessary to specify robust requirements for its member companies for them to be credible licensees of the Fairtrade mark. These requirements would verifiably have to be met for companies to be credible licensees:

- The performance check for the previous year demonstrated that the company has systematically worked towards general implementation of FWFs management system requirements.
- FWF has verified that the company reviewed its purchasing practices to facilitate payment of living wages in factories where Fairtrade certified cotton products are processed.
- FWF has verified that factories where Fairtrade certified cotton products are processed have made substantial progress regarding all of FWFs labour standards.
- FWF has verified that factories where Fairtrade certified cotton products are processed have measurably implemented payment of living wages.
- FWF has verified that the brand company has engaged its suppliers in activities that contributed to strengthening social dialogue between workers and management ¹⁴.

¹⁴ In 2012 FWF will roll out training activities in India as part of its project on anti-harassment committees and violence prevention systems in export-oriented garment factories.

End report FLO pilot option 1: independent verification

Annex

Annex A: Memorandum of Understanding

Annex B: Project description

Annex C: Report factory audits Prem Durai (Switcher) NOT PUBLISHED

Annex D: Report brand performance check Switcher 2011 (see www.fairwear.org)

Annex E: Report factory audits Armstrong (Nudie Jeans) NOT PUBLISHED

Annex F: Report brand performance check Nudie Jeans 2011 (see www.fairwear.org)

Annex G: Report brand performance check Clean & Unique 2010 (Charlie & Mary) (see www.fairwear.org)

Annex H: Explanatory note on hypothetical wage increase

Annex I: Calculations on hypothetical wage increase (Switcher)

Annex J: Calculations on hypothetical wage increase (Nudie)

Annex A

Memorandum of Understanding

between

Fairtrade International (FLO), Strategy and Policy Unit,

Max Havelaar Foundation, Switzerland,

Stichting Max Havelaar, Netherlands,

and

Fair Wear Foundation

1. Parties

The parties to this MoU are as follows:

- 1.1 Fairtrade International (FLO) as represented by the Director of Strategy and Policy Unit
- 1.2 Max Havelaar Foundation Switzerland (MHCH) as represented by the Head of Quality & International Cooperation
- 1.3 Stichting Max Havelaar Netherlands (MHNL) as represented by the Director
- 1.4 Fair Wear Foundation (FWF) as represented by the Director

FLO is the organization that coordinates Fairtrade labelling at an international level. Its tasks are to:

- Set international Fairtrade standards
- Organize support for producers around the world
- Develop global Fairtrade strategy
- Promote trade justice internationally

Fairtrade's vision is a world in which all producers can enjoy secure and sustainable livelihoods, fulfill their potential and decide on their future. Fairtrade's mission is to connect disadvantaged producers and consumers, promote fairer trading conditions and empower producers to combat poverty, strengthen their position and take more control over their lives.

Max Havelaar Foundation Switzerland (MHCH) and Stichting Max Havelaar Netherlands (MHNL) are two of the total 24 members of Fairtrade International, which include 19 Labelling Initiatives (LI's), three Producer Networks and two Associate Members. Fairtrade Labelling Initiatives license the FAIRTRADE Certification Mark on products and promote Fairtrade in their territory. As founding members, MHCH and MHNL helped to establish FLO in 1997.

Fair Wear Foundation strives for good labour conditions in branches of industry of which the main manufacturing process is sewing, by joining forces of business associations, trade unions and NGO's.

FWF realises good labour conditions by:

- Verifying the efforts made and results achieved by affiliates and ambassadors towards the implementation of the Code of Labour Practices step-by-step, in the company's internal management system as well as in the factories where their products are manufactured.
- Stimulating sound industrial relations worldwide and, wherever possible, harmonizing policies and methods.
- A glossary of terminology used by FWF can be found in Appendix 1 to Annex 1.

The above mentioned parties to this MoU will be further referred to as 'parties'.

2. Background

In 2004, the FLO Board approved a two stage approach to labelling textiles. In Phase 1, just cotton is Fairtrade certified and labelled. For Phase 2, the FLO Board expected that a full Fairtrade label for the final textile product would be developed covering the cotton farming, processing, manufacturing to the final consumer end product. The decision for a two-phase approach was taken on the basis of several exchanges with different stakeholders. Developing the two phases was regarded as key in carving out FLO's final approach to the textile supply chain.

In 2009, FLO began developing its Phase 2 approach to textiles where it will research and evaluate five options to arrive at a decision by the end of 2011. The decision can be to develop standards for textiles or to adopt an alternative approach within the ICCO funded Textiles Project for "Improving Social Compliance in the Textiles Chain". The overall aims of the ICCO-funded FLO textile project are to

1. Measurably improve the working and living conditions along the textile supply chain for Fairtrade-certified cotton
2. Investigate how Fairtrade elements can be added in the textile chain
3. Define FLO's definitive approach to the textile chain and, provided the selected approach implies this, translate it into standards.

In the project proposal it was stated that it is paramount for FLO to achieve this by cooperating closely with existing initiatives.

The five options developed after multi-stakeholders' consultations are as follows:

1. *Third Party Verification (Post farm levels);*
2. *Development & Empowerment of Textiles Workers;*
3. *Fairtrade Framework for Developing Possible Standards for Textiles;*
4. *Fairtrade Premium Benefit and Social Investment for Workers; and*
5. *Improvement in Fairtrade Certified Cotton Standards Only*

Testing of each option will be led by an LI with oversight from FLO. FLO's Board will determine in 2011 the next steps in textiles based on the options-based analysis and results of the various pilots.

3. Purpose and Scope

The purpose of this MoU is to facilitate and strengthen the collaboration between FLO e. V., FWF, MHCH and MHNL in the project led by MHCH regarding Option 1. It is needed to ensure uniformity and transparency in data release and evaluation.

The scope of this MoU covers the relationship between FLO e. V., MHCH, FWF and MHNL alongside their roles and responsibilities in the project “Researching how third party verification can contribute to improving social compliance in the textile supply chain of Fairtrade-certified cotton” outlined in Annex 1.

4. Goals

The aims of the project are

1. To explore to what extent working with third party verification can contribute to measurably improving the working and living conditions along the textile supply chain for Fairtrade-certified cotton.
2. To explore how the verification approach can be applied further up the supply chain, that is in ginning, spinning, knitting/weaving, dyeing.
3. To investigate whether and how Fairtrade elements can be added in the individual stages of the textile chain (ginning, spinning, knitting/weaving, dyeing, cut-make-trim) and how a verification approach could deliver on this.
4. To evaluate whether working with a third party – for example the Fair Wear Foundation (FWF) – creates a value added for both sides and in particular constitutes a cost-effective way towards achieving the overall goal of measurably improving working and living conditions along the textile supply chain for Fairtrade-certified cotton.
5. For FLO: to learn about the FWF verification approach and methodology.
6. For FWF: to learn about the FLO certification approach and methodology and applying and testing its own verification approach further up the supply chain (dyeing, knitting/weaving, ginning, spinning).

In the context of this project verification is defined as a confirmation that an operator has made efforts and achieved results in measurably improving the working and living conditions along the textile supply chain for Fairtrade-certified cotton, based on the requirements laid down in a Code of Labour Practices.

This MoU specifies the terms agreed between the parties for cooperation with respect to the aims mentioned above.

5. Duration

This MoU will be valid retroactively from 1 January 2011 and shall apply on the duration of the project.

6. Responsibilities

The table below details the parties' involvement within the scope of this MoU.

Roles	FLO e. V.	MHCH	FWF	MHNL
Project development	x	x	x	x
Funding	x	x	x	x
Steering Committee Membership (Representative Function from this pilot into the overall Textiles Project)		x		
Management contacts with participating textile companies		x	x	x
Project Lead		x		
Project Team members	x		x	x
Third party verification			x	
Evaluation results	x	x	x	x
Communication	x	x	x	x

7. Financial arrangements

See Annex 2.

8. Reporting

The reporting procedure will be applied as described in Annex 3. The FLO's template for the final report will be used.

9. Principal Contacts

The principal contacts for the duration of this MoU related to its application among the parties shall be:

For FLO: Rossitza Krueger, Textiles Policy Manager

For MHCH: Bernhard Herold, Head of Quality & International Cooperation

For MHNL: Roosmarie Ruigrok, Market Manager Cotton

For FWF: Ivo Spauwen, International Verification Coordinator

10. Agreement on communication

10.1. In order to achieve the objectives of the project on Option 1 the parties agree to act jointly and take all necessary measures in good faith. Therefore all parties shall mutually allow access to such information that is necessary in the process of achieving the mentioned objectives.

10.2. External communication about the project:

In case of planned publications, press releases, or other official communication material about the project, the Communications Department of FLO e. V. will be provided with a copy of the proposed document and its contents. The Communications Department will be responsible for approving materials within 7 working days. The parties shall agree if participating retailers or textile producers should be made anonymous and if it is necessary, to what extent.

10.3 External communication and publications by involved parties (FLO e. V. excluded) as well as participating textile companies and manufacturers about their involvement in pilot project:

In case of planned publications, press releases, or other official communication material the Textile Manager at FLO e. V. and the Communications Department at FLO e. V. should be provided with a copy of the proposed information. FLO e. V. will be responsible for review and approving materials within 7 working days.

10.4 Logos:

Logos are of special meaning for the parties. In the framework of this pilot participating textile companies and manufacturers will only be allowed to use the logos of the involved parties (i.e. the FT mark and the FWF logo) based on the existing contractual relationship between these companies and the respective party or parties (license agreement, certification contract, membership agreement). There will thus be no enhanced use of any of the parties' logos due to this pilot.

10.5 Transparency on cooperation:

As part of their commitment to the principle of transparency parties will publish a joint press release. Parties will jointly publish an executive summary of the MoU. After the evaluation of cooperation a final report, which will include an overview of conclusions, recommendations and lessons learnt, will be published jointly.

10.6 Transparency on involved production sites:

Provided the textile companies participating in this pilot agree to this, a list of their production sites involved in the pilot may be published by the parties.

If an involved participating textile company or manufacturer publishes information about the activities carried out in connection with this pilot project in an involved production site, this requires prior approval by the parties.

10.7 Transparency on results of verification activities:

FWF will publish the reports from complaints and MSAs on its website in accordance with its standard working methods.

11. Suspension and termination

Any of the parties may, upon giving three (3) calendar months notice, announce in writing its intention to terminate this MoU.

In case of disputes related to the application of this MoU among participants, they are encouraged to seek amicable settlement in a dialogue process amongst parties in the spirit of the mutual trust and continuous improvement that underlies the Fairtrade network.

Should any of the provisions of this MoU be or become invalid in part or in whole, or should there be an omission in the present MoU, the remaining provisions of the present MoU remain valid.

Signatures

For Fairtrade International (FLO)

For Max Havelaar Foundation, Switzerland

Louise Luttkholt
Director Strategy and Policy

Bernhard Herold
Head Quality & International Cooperation

Date: _____

Date: _____

For Stichting Max Havelaar, Netherlands

For Fair Wear Foundation

Peter d'Angremond
Director

Erica van Doorn
Director

Date: _____

Date: _____

Annex B

Project: Researching how third party verification can contribute to improving social compliance in the textile supply chain of Fairtrade-certified cotton
(Option 1 of FLO's options based approach in textiles)

1. Purpose of the project

The purpose of the project is to explore one out of five options which were identified in a ICCO-funded project carried out by FLO. The other four options are:

- Development & Empowerment of Textiles Workers
- Fairtrade Framework for Developing Possible Standards for Textiles
- Fairtrade Premium Benefit and Social Investments for Workers
- Improvement in Fairtrade Certified Cotton Standards only

The overall aims of the ICCO-funded FLO textile project are to

1. *Measurably improve the working and living conditions along the textile supply chain for Fairtrade-certified cotton*
2. *Investigate how Fairtrade elements can be added in the textile chain*
3. *Define FLO's definitive approach to the textile chain and, provided the selected approach implies this, translate it into standards.*

In the project proposal it was stated that it is paramount for FLO to achieve this by cooperating closely with existing initiatives.

The aims of this Project are

- a) To explore to what extent working with third party verification can contribute to measurably improving the working and living conditions along the textile supply chain for Fairtrade-certified cotton.
- b) To explore how the verification approach can be applied further up the supply chain, that is in ginning, spinning, knitting/weaving, dyeing.
- c) To investigate whether and how Fairtrade elements can be added in the individual stages of the textile chain (ginning, spinning, knitting/weaving, dyeing, cut-make-trim) and how a verification approach could deliver on this.
- d) To evaluate whether working with a third party – for example the Fair Wear Foundation (FWF) – creates a value added for both sides and in particular constitutes a cost-effective way towards achieving the overall goal of measurably improving working and living conditions along the textile supply chain for Fairtrade-certified cotton.
- e) For FLO: to learn about the FWF verification approach and methodology
For FWF: to learn about the FLO certification approach and methodology

In the context of this project verification is defined as a confirmation that an operator has made efforts and achieved results in measurably improving the working and living conditions along the textile supply chain for Fairtrade-certified cotton, based on the requirements laid down in a code of labour practices.

2. Project duration

12 months (December 2010 – November 2011)

3. Project overview

The project will research the existing (or possibly new) supply chains which are using Fairtrade-certified cotton of two or three companies which already are members of the Fair Wear Foundation (FWF) and are licensees of a labelling initiative (LI) who is member of FLO (e.g. Max Havelaar Switzerland).

It will in particular analyse the application of the FWF verification methodology – including the **wage ladder method** for benchmarking actual wages against different definitions of minimum and living wages (see Appendix I) – further up the supply chain (in ginning, spinning, knitting/weaving, dyeing).

It will further analyse, whether and how Fairtrade elements can be added in the final stage of the textile chain, i.e. the garment manufacturing stage CMT (cut-make-trim).

For a glossary of the terminology used by FWF see Appendix II.

4. Project partners

The Max Havelaar Foundation Switzerland will lead the project under guidance by FLO.

The project will be carried out by the Fair Wear Foundation¹.

The project is supported by Stichting Max Havelaar Netherlands.

Two or three companies who are both members of FWF and licensees for Fairtrade certified cotton. The following companies are confirmed to participate in the project:

- Switcher SA was the first company to agree to participate in the pilot and to contribute to it financially. Switcher produces its garments mostly in India. It was the first company to work with Fairtrade certified cotton and also the first Swiss company to become member of the FWF.
- Nudie Jeans was the second company to agree to participating in the pilot and to contribute to it financially. Nudie Jeans produces mostly in Italy and Portugal. In 2011 the company decided to start working with an Indian supplier for t-shirts made of Fairtrade certified cotton. Nudie Jeans has a long-term relationship with Amnesty International in Sweden, which goes back to 2001.

It has proven difficult to convince companies to participate in the pilot, since already today most consumers, when purchasing garments made with Fairtrade-certified cotton, assume they are actually purchasing “Fairtrade garments”. However, the advantages for participating companies are the following:

- First mover, pioneer bonus: Participating companies will be able to claim they have assisted FLO in setting up a consistent textile approach
- They will have a comparative advantage when later on implementing the final FLO textile approach
- They will learn more about the operators in their Fairtrade cotton supply chains, they will receive audit reports on these for free (while at the same time contributing to the pilot).
- They will have actual figures instead on only assumptions regarding the costs and effects of implementing living wages and Fairtrade elements in the textile supply chain.

¹ For the rationale why to carry out this project with the FWF see discussion paper dated 24 February prepared for the Utrecht Stakeholder Forum on 4/5 March 2010.

5. Project Team

- Bernhard Herold (MHCH, Head of Quality and International Cooperation, Project Lead)
- Ivo Spauwen (FWF, Verification Coordinator, Project Manager)
- Rossitza Krüger (FLO, SPU, Textile Manager)
- Roosmarie Ruigrok (MHNL)

6. Basic Requirements for the pilot, supply chain responsibility, Fairtrade elements

For the purpose of this pilot the existing ambitions² of the FWF approach for CMT and the FLO approach for Fairtrade-certified cotton shall be merged:

- The requirements with regard to social compliance against which performance is to be verified will be those contained in the “FWF Code of Labour Practices”.
- All operators in the Fairtrade-certified cotton chain are to be included.
- The pilot should be about verifying results, not just efforts.

With regard to supply chain responsibility there are basically approaches:

- a) The approach presently applied by FWF is that the responsibility to assure compliance with labour standards in the garment factories (CMT) lies with the affiliate member of FWF, usually a brand owner. In FLO terms this would correspond to the licensee.
- b) In the approach presently applied by FLO each individual operator along the whole supply chain has himself to demonstrate compliance with section 10 requirements (which is checked by the certifier FLO-CERT). This means the responsibility for social compliance lies with each individual operator.

For the purpose of this project approach a) is chosen. That means that the responsibility to assure compliance with labour standards would rest with the licensee and would be extended to the whole supply-chain. The feasibility, practicability and limitations of this approach shall be tested in the framework of this pilot project.

Fairtrade elements:

According to the Clean Clothes Campaign and most MSI's achieving a “living wage” would in itself not yet constitute a “Fairtrade element”, as this is regarded a basic human right. However, provided there are also effective mechanism in place allowing collective bargaining which can lead to even higher wages, the implementation of a “living wage” could be considered as a Fairtrade element in itself.

Irrespective of this the impact of the introduction of a “Fairtrade premium” in the CMT stage shall also be assessed in this pilot. For this purpose a “Fairtrade premium” will be defined as an amount corresponding to certain percentage (e.g. 5% or 10%) of a defined “living wage” (e.g. the Asia Floor Wage). It then will be merely calculated which total amount of Fairtrade premium would be generated at the CMT level on the basis of the garments made with Fairtrade-certified cotton only. For this purpose it will be necessary to measure the proportion between conventional garments and ones produced with FT cotton. The feasibility of setting up a structure to administer the Fairtrade premium in a comparable way as is done in FT hired labour set-ups will not be analysed in this pilot, as this is done in one of the other pilots.

For further details regarding FT elements in the CMT stage see Appendix III.

² For the existing basic requirements of FLO and FWF see discussion paper dated 24 February (chapter 4)

7. Project description

Issue / topic	Focus	output
Social compliance on CMT level	<ul style="list-style-type: none"> - Existing FWF verification methodology applied (social audits on behalf of member company, verification audits on behalf of FWF, management system audits at member, complaints mechanism, etc.). - Application of <u>wage ladder methodology</u> in order to assess gap between actual wages and different “living wage” thresholds. - Special focus on <u>purchasing practices</u> for garments made with FT-certified cotton (pricing, lead times). - Special focus on <u>quality of workers’ representation</u> and/or empowerment of workers. - Analyse whether there were findings which were missed by the chosen Section 10 approach. 	<ul style="list-style-type: none"> - Audit reports - Findings - Complaints - Real wage levels - Living wage gap analysis - Assessment of purchasing practises - Assessment of quality of workers’ representation - Assessment of Section 10 impact
Fairtrade elements on CMT level	<ul style="list-style-type: none"> - Calculate cost of introducing living wage (e.g. Asia Floor Wage) on CMT level overall. - What would it mean with regard to costs per piece? - What would an increase of 5-10% on top of Asia Floor Wage for garments from FT cotton mean? - Which volume of Premium funds would be generated? 	<ul style="list-style-type: none"> - Cost of introduction of living wage - Effects on sourcing (cost increase per piece) - Cost effect of additional FT premium on top of living wage (only garments from FT cotton)
Social compliance further up the supply chain	<ul style="list-style-type: none"> - Apply FWF verification methodology (verification audits) to all operators further up the chain (but not cotton farmers). - Are management system audits doable for operators further up the chain? - How can complaints procedures be introduced further up the chain? - Calculate costs for each operator to commission social audits one step up. - Application of <u>wage ladder methodology</u> in order to assess gap between actual wages and different “living wage” thresholds. - Analyse whether there were findings which were missed by the chosen Section 10 approach. 	<ul style="list-style-type: none"> - Audit reports - Findings - Complaints - Real wage levels - Living wage gap analysis - Assessment of quality of workers’ representation - Assessment of Section 10 impact

8. Project implementation / time frame

Phase	Description	Activities	Duration
I	Setting up the pilot	<ul style="list-style-type: none">- draft project proposal- set up budget and financing- find participating companies- define project team	October 2010/ March 2011
II	Detailed preparation	<ul style="list-style-type: none">- identify and map FT cotton supply chain operators of participating companies- plan audits	December 2010/ March 2011
III	Interim consultation	<ul style="list-style-type: none">- Steering group meeting in December- TWG in January 2011	December 2010/ January 2011
IV	Roll-out, project implementation	<ul style="list-style-type: none">- carry out audits and analysis- reporting by FWF to project lead	February-August 2011 (7 months)
V	Project report	<ul style="list-style-type: none">- write final report (beginning Sept.)- consultation with SC and TWG- finalize report for FLO	September 2011
VI	Draft final report & consultation	<ul style="list-style-type: none">- draft overall report with draft recommendations (by FLO)- Multi-Stakeholder meeting (Utrecht)- Include feedback in final report	October 2011
VII	Final report	<ul style="list-style-type: none">- Deliver final report to ICCO (Nov./Dec.)- Deliver final report to FLO Board (Dec.)	November / December 2011

9. Budget / Finances

Total costs for this project have been estimated at approx. € 50'000 – 64'000, depending on the actual number of participating companies, supply chains and number of audits carried out.

Confirmed pledged contributions:

- | | |
|-----------------------------------|------------|
| - FLO e.V. | € 20'000 |
| - MHCH (CHF 30'000) | € 24'000 |
| - MHNL | € 10'000 |
| - FWF (contribution in kind) | (€ 17'400) |
| - Participating companies (total) | € 10'000 |

Total (without FWF contribution in kind) € 64'000

10. Evaluation / Monitoring / Reporting

The project team will meet and discuss progress regularly during the implementation phase. The project lead will regularly report to and meet with the Steering group for the overall textile project (project leads of all options).

The evaluation of "Option 1 Pilot" (as well as the other pilots) will follow the assessment criteria laid down in the discussion paper "A Regard for Workers", prepared for the Utrecht meeting, chapter 6:

- **Credible**
- **Affordable**
- **Simple**
- **Effective**
- **Scalable**

Annex H: Explanatory note on estimated impact of hypothetical wage increase

The calculation of the impact of a hypothetical wage increase in factories included the following steps (refer to Annex I and J for examples).

1. On the basis of data that was gathered during factory audits FWF developed wage ladders in the reports of these audits. The wage ladder offers a visual picture of how existing wages compare against wage benchmarks that FWF obtains through consultation of local stakeholders. The wage ladders are enclosed in the reports of factory audits.
2. The relative gap between current wages and Asia Floorwage (assessed by using the wage ladder) was calculated in percentages for the highest and lowest salaries for each production department, and for the mode wage ¹.

Example (Switcher): in the CMT unit the lowest salaries would have to be increased by 145% whereas the highest salaries would have to be increased by only 45%.

3. On the basis of a detailed cost breakdown of the cost structure that was provided by the supplier, the share of salary expenses of total cost of the production unit was determined ². By taking this as a reference, a rough estimation could be made of the share of salary expenses in the cost of factory working minutes.

Example (Switcher): staff expenses comprise 70% of the general cost structure of the CMT unit (PDE II), a wage increase of 100% would result in a 70% increase in working minute cost. As the minute working cost of producing a single GAIA jersey at Prem Durai was 0.64 CHF, the share of salaries of minute working cost is $70\% \cdot 0.64 = 0,45$ CHF (highest salaries in CMT unit taken as reference).

4. For each department the estimated relative impact of a wage increase towards Asia Floorwage (AFW) (for lowest wage, mode wage and highest wage) was calculated in relation to the proportion of salary expenses as a part of minute working cost.

Example (Switcher): In the CMT unit the 45% increase towards AFW for the workers with highest wages would imply that factory minute working cost would increase by 0.20 CHF.

The attached overview of calculations (Annex I and J) provides an overview of how wage increases towards AFW would impact on working minute cost (increase in CHF) and retail price (increase in %).

For estimating the impact of the hypothetical increase the following was taken into account:

- As various living wage benchmarks exist, the Asia Floorwage Campaign benchmark for was taken as a proxy for living wages.
- Wages for a regular working week of 40 hours are used as a reference. In practice however working hours and wages are linked in practice as result of piece-wages. Also workers are committed to obtain a minimum take home wage

¹ Wage amount found to be paid most often in comparison to other wage amounts in the same department.

² This includes salaries for regular and overtime working hours, fringe benefits, allowances, social security, training expenses and recruitment costs.

in order to generate sufficient income. Also factories will be committed to reduce overtime work when the cost of labour for a regular working week increases, as payments for overtime hours are not taken into account these and other related complexities are not accounted for.

- The increase could be made on all garments (this would only be the case if the factory would produce 100% garments made with Fairtrade cotton). In practice the audited factories only a small proportion of the production constitutes garments made from Fairtrade certified cotton. Would the paying of a living wage be required from the factories for all employees (and a different approach is hardly feasible), the costs of the factory would obviously increase for all items produced, not only for the ones made with Fairtrade cotton.
- The present shape in which FWF develops wage ladders does not specify are at the highest / lowest salary level. For this reason the mode wage is most indicative: it refers to the wage level that is most often paid. Would the lowest (highest) wage be used, the impact would be greater (smaller).
- In practice it is difficult to assess the impact of a hypothetical wage increase in various manufacturing stages. The proportion of wage expenditures as a part of total costs differs per manufacturing stage. In practice it is difficult to separate costs for individual production stages for the studied factories as they are vertically integrated. Also, wage levels differ considerably across production stages. To simplify this calculation, it was decided that the current mode wage at the CMT unit would be taken as a reference as most workers are active in this operating stage. It is important to note that the estimated increases in other production stages that are mentioned in the excel overview are not cumulative: all stages are part of the value adding activities of the supplier on the basis of which a single FOB price is paid.

Annex I: Calculations on hypothetical wage increase

Fairtrade cotton T-shirt

Description	Rs	Present situation			Increase CMT mode salary to AFW without escalation		Increase CMT mode salary to AFW with escalation		Increase CMT mode salary to AFW with escalation, but with same factory gross margin	
		€	%	% retail price	€	% retail price	€	% retail price	€	% retail price
Material input (fabrics, lining, trimming, packing)		2.41		19%	2.41	18%	2.41	16%	2.41	16%
Total salary cost as part of factory minute cost		0.36	70%	3%						
Total factory working minute cost		0.52		4%						
Current wage CMT (mode)	3536									
Asia Floor Wage for India	7967									
Increase salary part of factory working minute cost	125%									
New total salary cost as part of factory minute cost					0.82	6%	0.82	6%	0.82	6%
New factory working minute cost					0.98	7%	0.98	7%	0.98	7%
Manufacturing cost		2.93		23%	3.38	25%	3.38	23%	3.38	23%
Factory gross average margin		0.29	10%	2%	0.29	2%	0.34	2%	0.29	2%
FOB Price		3.22		25%	3.68	27%	3.72	25%	3.68	25%
Transport / Insurance / import tax		0.15		1%	0.15	1%	0.15	1%	0.15	1%
Landed Cost		3.37		26%	3.83	28%	3.88	26%	3.83	26%
Fairtrade license fee		0.24		2%	0.24	2%	0.24	2%	0.24	2%
Warehouse, brand margin, etc.		2.59	77%	20%	2.59	19%	2.97	20%	2.94	20%
Wholesale price (excl. VAT)		6.20		48%	6.66	49%	7.09	48%	7.01	47%
Distribution, retail margin (incl. VAT)		6.80	110%	52%	6.80	51%	7.78	52%	7.69	52%
Retail price (incl. VAT)		13.01		100%	13.46	100%	14.87	100%	14.70	99%
Increase retail price					3.5%		14.3%		13.0%	

Annex J: Calculations on hypothetical wage increase

Fairtrade cotton T-shirt

Description	Rs	Present situation			Increase CMT mode salary to AFW without escalation		Increase CMT mode salary to AFW with escalation		Increase CMT mode salary to AFW with escalation, but with same factory gross margin	
		€	%	% retail price	€	% retail price	€	% retail price	€	% retail price
Material input (fabrics, lining, trimming, packing)		3.40		12%	3.40	12%	3.40	11%	3.40	11%
Total salary cost as part of factory minute cost		0.18	41%	1%						
Total factory working minute cost		0.45		2%						
Current wage CMT (mode)	3302									
Asia Floor wage for India	7967									
Increase salary part of factory working minute cost	141%									
New total salary cost as part of factory minute cost					0.45	2%	0.45	1%	0.45	1%
New factory working minute cost					0.71	2%	0.71	2%	0.71	2%
Manufacturing cost		3.85			4.56		4.56		4.56	
Factory gross margin		1.15	30%	4%	1.15	4%	1.23	4%	1.15	4%
FOB Price		5.00		17%	5.26	18%	5.34	17%	5.26	17%
Customs, transportation, warehouse, license fee, etc.		2.19		8%	2.19	7%	2.19	7%	2.19	7%
Selling agent provision		1.20	10%	4%	1.20	4%	1.26	4%	1.26	4%
Gross margin		3.61	72%	12%	3.61	12%	3.85	13%	3.79	13%
Wholesale price (excl. VAT)		12.00		41%	12.26	42%	12.64	41%	12.51	41%
Distribution, retail margin (incl. VAT)		17.00	142%	59%	17.00	58%	17.91	59%	17.72	59%
Retail price (incl. VAT)		29.00		100%	29.26	100%	30.55	100%	30.23	100%
increase retail price					0.9%		5.4%		4.2%	