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Statement
of
Stephen Lamar
Executive Vice President
American Apparel & Footwear Association

The Costs and Consequences of Dodd-Frank Section 1502: Impacts on America and the Congo

Subcommittee on International Monetary Policy and Trade
House Financial Services Committee

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Thank you for providing us a chance to testify before the Subcommittee this morning on the Costs and Consequences of Dodd Frank Section 1502.

The American Apparel & Footwear Association (AAFA) is the national trade association of the apparel and footwear industries, and their suppliers. Our members include companies that design, manufacture, transport, distribute, and sell apparel and footwear in and throughout the United States and globally. AAFA has about 350 member companies who own, produce for, or market more than 900 brands of clothing, footwear, and other fashion products. Nearly all stakeholders in the industry supply chain are represented in our membership, including large, medium, small, and micro businesses; retailers of all sizes; designers; manufacturers; importers; wholesalers; private label; brand owners; and suppliers of inputs and services. Our members include publicly traded and private companies, as well as suppliers to both. Our industry employs about 4 million U.S. workers, about 3 percent of the U.S. workforce.

As you can imagine, our industries are among the most globalized in the world. Our members make and sell product in virtually every country in the world. As a result, even the smallest companies often have complicated supply chains that stretch across continents, countries, and factories. Working with multiple partners in multiple time zones and facing multiple regulatory environments, they have to manage a diverse array of compliance challenges covering labor, health, environment, product safety, intellectual property, chemical management, product quality, security, labeling, and customs. So why am I here? Because the impact of Dodd Frank Section 1502 is reverberating through industries across the spectrum, including ours in a significant way.

It is with this background in mind that we offer these comments.

1601 North Kent Street
Suite 1200
Arlington, VA 22209

(703) 524-1864
(800) 520-2262
(703) 522-6741 fax
www.wewear.org

We strongly support the goals of the Conflict Minerals provision in the Dodd Frank Act. Collectively and individually, our members have participated in similar kinds of initiatives to ensure that our sourcing does not inadvertently support undesirable practices, such as forced child labor toiling in the cotton fields in Uzbekistan, leather from cattle raised on illegally cleared rainforest land in Brazil, or wool from mulesed sheep in Australia.

While we support efforts to prevent Conflict Minerals from entering into global supply chains, we remain deeply concerned over several elements of this provision on our industry. Let me explain.

First, the impact of Section 1502 on the business community is deceptively large – much larger than we believe was intended. The fact that I am testifying here today – on a bill that was largely intended to focus on the electronics industry – is one indicator of that fact.

Although the law initially targets about 6000 publicly traded companies, it also affects those companies' suppliers – in many cases small privately held businesses – as they are being increasingly notified by their customers that they will have to certify that their own supply chains are conflict free. Many companies in our industry initially thought they were not covered but are only now finding out – in some cases in the past few weeks – that they are impacted. Many others still don't even know. We have yet to locate an apparel or footwear company who can tell us with certainty that they are not affected.

Why? Many businesses in our industry probably do not realize that their products may contain one of the four conflict minerals. When you think of a garment or a shoe, you think of the fabric, the fit, the design, or maybe the price. But you usually don't think of wearing tin unless perhaps you are watching *The Wizard of Oz*. Indeed, initial reviews suggested these minerals could be present only in some accessories and certain electronic components, such as the "light-up" assemblies in certain kids' shoes. But companies are now learning that tin, for example, is a commonly used filler in certain PVC used in soles of shoes or in metal components in buttons, zippers, and heel tips. In fact, several of our member labs suggest that the use of tin has actually increased in recent years to replace metals like lead or cadmium, which have been targeted by recent product safety initiatives, including the Consumer Product Safety Improvement Act (CPSIA) passed by Congress in 2008.

In our industry, but I suspect in many others, there is still an incredible lack of awareness of this provision, much less the breadth of companies this law will affect.

Second, the provision has a major effect on those in the business community who are least able to affect change in the conflict zones in Africa.

In our industry, the uses of these minerals are *de minimis* even after accounting for greater uses in recent years. Yet the smallest apparel or footwear company will be

equally liable as a company that is a major consumer[1] of large quantities of these minerals. Although we are now learning that tin is more commonly used than we thought, its use is confined in our industry to very, very small quantities that are encountered inconsistently across a great many styles and brands.

Compounding this is the simple fact that fashion changes all the time. Except in rare circumstances, design houses are constantly varying component pieces and suppliers to accommodate ever changing styles and consumer demands. In one year, a company may find that four products, or styles, out of thousands trigger Section 1502 reporting. The following year may be zero and the year after that may be 20. Compare this to an electronics company that sources millions of the same components over several years with no design or input changes. Just as important, the electronic or accessory components containing the subject minerals in a garment or shoe are often secondary to the manufacturing of the clothing or footwear item. In most cases they will have been purchased off the shelf from a supplier who is itself many steps removed from the mines, or even the smelters, where these minerals originate.

Moreover, only about four percent of the world's production of tin – which is the mineral that is probably of the biggest concern to our industry – comes from the Congo and surrounding areas. This means that we are expending extraordinary resources to trace the origin of a mineral that sometimes is encountered at *de minimis* levels in a few of our products, depending on the season and style, to make sure they do not originate in mines that are found in a region that accounts for four percent of global production of that mineral.

The bottom line is that pressure to create and promote conflict free mineral supply chains will not come from our industry, even if we could somehow declare ourselves to be 100 percent conflict free. While the apparel and footwear industries are leaders in social compliance in many areas, we simply don't have the purchasing power or the business relationships to affect change in this area. However, if other industries, such as the major users of these minerals, are successful in affecting change, our industries will naturally follow suit and absorb that change as well.

Third, the costs associated with Section 1502 are enormous.

Here again, we believe the costs are far larger than the authors expected. Some estimates by Tulane University and the National Association of Manufacturers (NAM) put the cost at $8 or $9 billion, respectively. The costs could be far higher, especially as the impact on other industries like ours is factored into the equation. In the apparel and footwear industry alone it could be in the hundreds of millions of dollars. Consider this: Unless a company is not publicly traded and sells to non-publicly traded customers, it will have to incur costs to determine if any of the four conflict minerals are found in any quantity in its supply chain in a manner that is necessary to the functionality or production of the product. If such determinations find minerals, conflict free or not,

[1]Unless of course that company is not publicly traded and does not sell to non-publicly traded customers in which case it won't be affected at all.

further regulatory costs are incurred in the form of audits and due diligence. Additional costs on top of that come in the form of supply chain training, compliance and legal reviews, and the like. In our industry, such costs would be incurred each season as the thousands of new styles of product introduced must be scrubbed to determine if they contain these minerals and, if so, the source of those minerals.

Absorbing such costs at this point in our economic recovery would be extraordinarily difficult, especially in our price competitive industry where margins are always tight. Moreover, such cost pressures would come as our supply chains are still working to incorporate other more established regulatory requirements, such as recently enacted product safety laws.

Fourth, the lack of tracing technology and infrastructure means that companies do not have a clear and affordable path for compliance.

The draft regulations do not allow companies to simply declare that they do not know if they have conflict minerals in their supply chain because there are insufficient tools to answer the question properly. Yet this reality is affecting most companies today. Our industry is still struggling to create verifiable and effective tracing technologies for materials that make up a central part of our supply chains, such as wool or cotton. We are learning that even greater challenges exist in the minerals industry, which account for far smaller parts of our sourcing.

Going forward, I'd like to make a few recommendations:

First – The regulations need to put on hold until the infrastructure and technology exist to allow companies to come into compliance. Forcing companies to make public disclosures without the proper tools to verify those disclosures is costly, damaging to the underlying goal, and erodes public confidence in the corporate disclosure requirements.

Second – Likewise, the regulations should be put on hold until there is a comprehensive cost/benefit analysis in place that enables policy makers to understand if the regulations can work as intended. Such an approach is a basic element of good government and is consistent with a recent Executive Order directing agencies to conduct such cost benefit reviews.

Third – Once the tools are in place, the regulations need to be phased-in to focus on those industries whose consumption of these minerals will have a major impact in achieving the underlying goal of 1502.

Fourth – The final regulations need to address several critical threshold issues, in addition to the above point about focusing the application of this rule to the industries, products, and components that have the most impact so that the rule would have most effectively achieve its underlying goal. In our comments to the SEC, we detailed a number of these, including:

- Clear definition of the phrase "necessary to the functionality or production" to permit exemptions where the primary function of the product does not involve conflict minerals.

- The designation of a *de minimis* provision.

- Clarification that recycled material is not treated as originating in the DRC or adjoining countries, and therefore does not trigger further reporting or audit requirements.

- Clarifications that the primary obligations should rest with those in the supply chain who are closest to the manufacturing and component purchases vis-à-vis retailers and licensors.

- Flexible, but not prescriptive, guidance on what constitutes "due diligence" and "reasonable inquiries" to accommodate widely varying supply chains in different industries.

Fifth - Once regulations are in place, there needs to be flexible enforcement accompanied by education. This is particularly since SEC penalties can involve heavy fines and jail time. New regulations take time to understand and absorb, especially given today's complicated global supply chains.

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Thank you again for providing this opportunity to testify on this important issue. As you can imagine, this rule has caused considerable confusion in our industry and in others, particularly since Section 1502 was included in Dodd Frank legislation during Conference without any hearings or opportunities for prior stakeholder input.

Although we support the goals of the Section 1502 Dodd Frank Act to help ensure that such minerals not be used to fuel African conflicts, we are concerned that the regulation may result in significant compliance costs and burdens to achieve a stated goal that is difficult, if not impossible to meet. We are also concerned that many companies may still be unaware of the potential compliance requirements they may face.

We believe the best approach forward is to first answer key questions about the regulations and then define a clear, predictable, and phased in regulatory and enforcement regime that focuses on those products and processes with the greatest opportunity to make a difference.