



WORKER RIGHTS CONSORTIUM

Worker Rights Consortium Update on Code of Conduct Violations at PT Panarub (Indonesia) July 3, 2006

Background

The Worker Rights Consortium (WRC) undertook a factory assessment of PT Panarub in March of 2004 in response to a request made by Adidas and Oxfam Community Aid Abroad (OCAA), an Australian non-governmental organization, to review allegations of worker rights violations. While the facility does not produce collegiate licensed apparel, given the company's size and prominence in the industry and given the importance of Adidas as a licensee to many WRC affiliate universities, the WRC decided it would be prudent to undertake the inquiry.

PT Panarub is one of the world's largest suppliers of high-end sports shoes and cleats for Adidas. For the past several years this facility of 12,000 employees has made shoes for world-renowned soccer players and teams, and most recently has produced the majority of shoes for the soccer teams sponsored by Adidas competing in the 2006 FIFA World Cup. The factory produces almost exclusively for Adidas (with the exception of a very small amount of production of an Indonesian athletic shoe brand, Specs). Adidas operates one of their main product research and design offices inside the PT Panarub factory grounds.

The primary allegations that Adidas and OCAA initially requested the WRC investigate were concerns about PT Panarub management's alleged infringements on employees' associational rights over a period of several years. The WRC conducted an assessment of these allegations as well as compliance with other core code of conduct standards. The WRC found a number of serious violations of Indonesian law and applicable codes of conduct. PT Panarub management and Adidas agreed to the majority of the WRC's recommendations for remedial action. In September of 2004 the WRC published an updated Summary of Findings and Recommendations for PT Panarub (Indonesia) which included extensive information about the status of remediation progress at the factory. From the end 2004 to 2005 the vast majority of the WRC's recommendations were implemented successfully and there were major improvements in working conditions at PT Panarub. Unfortunately, in late 2005 new code violations took place at PT Panarub. This memo serves as an update on the WRC's monitoring activities at PT Panarub and the new findings and recommendations since October 2005.

Strike & Illegal Dismissals at PT Panarub

On October 15th, 2005 approximately 50 employees from one of the two unions at PT Panarub, Perbupas, engaged in a one-day strike calling for higher holiday bonuses and for wages to be raised in line with inflation. Perbupas gave notice for the strike in advance, as required by Indonesian law. The strike followed a series of unsuccessful attempts by the union to reach resolution to the issues through collective bargaining. Shortly after the strike 33 of the top union officers and leaders of Perbupas received letters informing them they were being dismissed from the factory.

The WRC subsequently engaged in an assessment of the allegations surrounding the strike and dismissals. The WRC concluded, based on a review of the facts of the case, that the termination of the group of 33 employees in October, 2005 was unlawful. This conclusion is based on the timing of the terminations (which took place just after the employees participated in a legally registered strike), the identity of specific individuals terminated (all key leaders in one of PT Panarub's two legally registered unions, Perbupas), other circumstances related to the firings such as management's illegal efforts to interfere with workers' exercise of their associational rights through attempts to compel workers not to strike by providing monetary incentives to non-strikers and closing factory doors during the time of the strike (thus violating Article 137 and 144 of Indonesia's Manpower Act No. 13 of 2003), and the lack of any compelling evidence or counter-explanation provided by PT Panarub for the terminations.

In November 2005 the WRC provided a summary of findings and recommendations to PT Panarub management, Adidas, OCAA, and the two unions at the factory (SPN and Perbupas) regarding the October strike. In this summary the WRC recommended that the industrial dispute should be resolved internally through reinstatement of the 33 employees and a joint management-union investigation into the alleged violations of the collective bargaining agreement. Neither Adidas nor PT Panarub management, however, supported an internal resolution of this case. Despite a failure to provide evidence in support of their assertion that the terminations were legal, both Adidas and the factory insisted the dispute be taken to the labor court and the legal process be allowed to run its full course.

The WRC recommended an internal resolution instead of recourse through the legal system, because of the obvious lack of legal grounds for termination and because legal processes in Indonesia, particularly those involving the labor courts, are notorious for being both lengthy and sharply biased against workers. Indeed, seven months later, the legal process has yet to come to an end and several incidents during the course of the legal process reflect clear bias on the part of the Regional Ministry of Manpower and the Central Labour Court. The following is a summary of the WRC's main concerns regarding the lack of due legal process that the case of 33 Panarub employees has received thus far:

- In violation of the Indonesian labor code, there was no good faith effort made to resolve the dispute first through bipartite negotiations. Instead, PT Panarub management insisted on the case being taken directly to the Regional Ministry of Manpower.
- The Regional Ministry of Manpower recommendations showed no finding of 'gross wrong-doings' (the standard legal grounds for termination) in their case summary and recommendations, yet still gave PT Panarub permission to terminate the employees.
- The Central Labour Court verdict was suspiciously released only one day after receiving the case from the Regional Ministry of Manpower (a turn-around time completely unprecedented for Indonesian court processing).
- The Central Labour Court's verdict also did not show any finding of 'gross wrong-doings', yet still gave PT Panarub permission to terminate the employees.
- Perbupas has yet to receive an official copy of the Central Labour Courts verdict despite the verdict being issued in January and mailed to PT Panarub management in March.

It is important to note that the length of the court procedures has resulted in significant hardship for the 33 dismissed employees and their families. Due to this long spell of unemployment, many are now facing eviction from their homes and removal of their children from primary school. Two of the 33 workers were recently compelled by such economic difficulties to accept severance, and relinquish their legal claim to reinstatement. PT Panarub management, with Adidas's encouragement, recently moved to provide some economic assistance to the employees while their case undergoes further legal review. These funds will help to some extent, but come after many months without pay and after employees have already accrued large debts.

Currently Adidas and PT Panarub management are encouraging the 33 employees to appeal their case to the Supreme Court. Given the clear lack of evidence for the dismissals since the beginning and the flaws in the legal process thus far, not to mention the length of time a Supreme Court hearing will require and the economic hardships the employees are already facing, the WRC sees no benefit in any further legal appeal by any party.

The WRC has also heard credible, mutually corroborative testimony that some of the workers from the group of 33 have been approached by members of PT Panarub management (specifically by the General Affairs Department) in recent weeks and pressed to accept severance rather than continuing to pursue reinstatement.

The WRC's conclusion that the 33 Perubpas leaders were illegally terminated is further supported by the recent findings and recommendations of the Indonesian Human Rights Commission (known as "Komnas HAM") which found in the case of each of the 33 workers that the terminations constituted violations of both Indonesia's labor code and human rights law (*Komnas HAM report No. 257/Rek/Ekosob/V/06*).

Response from Adidas and Status of Remediation

Despite months of engagement by the WRC, PT Panarub has refused to take appropriate action to remediate the violations. The WRC regrets also having to report that Adidas has failed to act appropriately to correct these violations – initially asserting the firings were legitimate and, subsequently, acknowledging reinstatement is necessary but failing to communicate this clearly and firmly to PT Panarub management. Moreover, the WRC is gravely concerned by Adidas's recent announcement of plans to reduce orders substantially at PT Panarub, for reasons entirely unrelated to code compliance concerns. This action not only threatens the livelihood of many PT Panarub workers but it also complicates efforts to achieve the reinstatement of the unlawfully terminated workers.

Adidas has claimed that they are at an "impasse" with PT Panarub management regarding the issue of reinstatement, but after serious and thorough review, the WRC has not seen any evidence indicating that Adidas has fully and unequivocally issued a message to management that the 33 Perubpas leaders must be immediately reinstated. In communication with the WRC more than four weeks ago Adidas stated that "we [Adidas] will proceed to make a formal written request to Panarub to reinstate the dismissed workers. The request will be non-negotiable" (*email from Bill Anderson, Adidas Head of Social & Environmental Affairs Asia Pacific, June 3, 2006*). To date, no letter has been sent. Moreover, in the WRC's most recent meetings with Adidas and PT Panarub management, Adidas openly debated the feasibility of reinstatement with PT Panarub management, thus contradicting the message it had pledged to send: that reinstatement was *not* negotiable. Given the inaction on the part of Adidas, the WRC can only conclude that Adidas's lack of clarity on the point of reinstatement is a major barrier to a positive resolution.

Furthermore, on February 20, 2006 Adidas sent a letter to the National Human Rights Commission of Indonesia stating that Adidas fully supported the Commission's investigation into the legality of the dismissal of 33 employees. From February to late May, Adidas made several statements in written and verbal communications with various stakeholders (Perubpas, WRC, Oxfam, and the Clean Clothes Campaign) that Adidas would fully support the recommendations

of the Commission. On May 31, the National Human Rights Commission issued its final recommendations, stating that:

“...because PT Panarub Industry cannot prove the accusations brought before the court regarding the dismissal of the 33 employees, then it stands that the dismissal of these employees not only violates the legal provisions as laid out in Article 158, paragraph (1) and (2) of Act No. 13, 2003 regarding Manpower, but is also a violation of Human Rights, as laid out in Article 17, and 38, paragraph (2) of Law No.39, 1999 regarding Human Rights; Article 10 of the Universal Declaration on Human Rights 1948; Article 14, paragraph (1) of the International Covenant on Civil and Political Rights (ICCPR); and Article 28D, paragraph (1) of the Indonesian Constitution, 1945.

In accordance with our authority as detailed in Article 89, paragraph (4) of Law No.39, 1999 regarding Human Rights, the National Commission for Human Rights issues the following recommendations in the case of human rights violations by PT Panarub Industry: ...

5. That management from Adidas Indonesia’s Representative Office should to respond to the human rights violations carried out by PT Panarub Industry against the 33 employees. The National Human Rights Commission hopes that management from Adidas Indonesia’s Representative Office will give a response such that the human rights violations described above are not able to continue nor occur a second time.

With these recommendations it is sincerely hoped that the parties assigned and authorized to carry out the Commission’s recommendations do so, and that they represent the Commission’s true effort in protecting and fulfilling workers’ human rights.” (*Komnas HAM report No. 257/Rek/Ekosob/V/06*)

To date, despite its pledges to do so, Adidas has failed to express its full support for the Commission’s recommendations; rather, Adidas is pursuing yet another opinion from the Central Ministry of Manpower and Ministry of Justice (concerning the discrepancy between the Central Labor Court’s verdict and that of the National Human Rights Commission, and whether or not the National Human Rights Commission’s recommendations must be followed by the factory).

Adidas’s failure to understand and/or acknowledge understanding of the actual details surrounding the strike, of the widely-recognized flaws in the legal process, and of the lack of evidence for termination highlighted by every party that has looked at the case thus far suggests to the WRC a lack of concern and commitment on Adidas’s part to resolve this case fairly and in a timely fashion. Moreover, Adidas’s offered “next step” of discussing the discrepancy between the Central Labor Court’s verdict and the National Human Rights Commission’s recommendations with the Ministry of Manpower and Ministry of Justice will only serve to delay further the resolution of this urgent case. The suggestion that there now be a debate over the validity of the National Human Rights Commission’s recommendations versus the Labor Court’s verdict with the Ministries themselves also directly contradicts Adidas’s prior pledge to fully support the outcome of the National Human Rights Commission’s investigation.

Additional Outstanding Code of Conduct Violations at PT Panarub

In addition to the unlawful firings of 33 Perbupas leaders in October 2005, PT Panarub has also failed to act on a WRC recommendation to remediate past instances of anti-union discrimination at the factory. As noted above, the vast majority of the WRC’s recommendations from the WRC’s

initial assessment of the factory in 2004 were implemented successfully during 2005. The major outstanding recommendation from this time, however, is the recommendation that PT Panarub and its two unions (SPN and Perbupas) conduct a union membership verification exercise in order to resolve discrepancies in union membership claims and to remediate past discriminatory practices of PT Panarub management.

In the WRC's first assessment of PT Panarub, the WRC Assessment Team identified a number of ways in which PT Panarub management actively and systematically discriminates against one union in the plant, Perbupas, in favor of the other union present, SPN. A few examples highlighted in the WRC's first report on PT Panarub include the use of the Human Resources Department's administrative process to channel workers into SPN without their consent and refusal to recognize workers' right to resign from one union and join another.

As a result of the inappropriate interference of management in workers' associational choices over a period of years, it is unclear whether the present union affiliation of a worker reflects that worker's free choice. The WRC, thus, concluded that the only viable means to make a fair and accurate determination as to which union each worker wishes to be part of is to conduct a membership verification process. During this process each worker at the factory should be provided with the opportunity to state their preference, in writing, and the choice of each worker should be respected by both unions and by management. This verification process should take place at the factory, on a specific day or consecutive days (depending on how much time is required), with measures to protect workers from coercion, and with neutral observers present.

Initially, PT Panarub management and Adidas both expressed support for the verification recommendation, but to date no complete verification has been conducted. The WRC has repeatedly articulated its preparedness to assist PT Panarub management and the unions to design and carry out this membership verification process as efficiently and fairly as possible, but to date neither PT Panarub nor Adidas has asked for further involvement by the WRC in this area. In mid-2005 a mini-verification exercise was conducted to clarify the membership of approximately 350 employees, but the exercise was quickly discontinued after the majority of the employees demonstrated their interest in affiliating with Perbupas.

Adidas Announces Plans to Greatly Reduce Orders at PT Panarub

Adidas recently announced that they will reduce their order volume at PT Panarub by 200,000 pieces a month starting in September, 2006; resulting in a layoff of approximately 2,000 employees (1/6th the current work force). Adidas has stated that orders will be reduced at Panarub regardless of how the case of the 33 Perbupas leaders is resolved. This action severely undermines the effort to achieve the reinstatement of the workers. The unilateral order reduction combined with Adidas' equivocation on the issue of reinstatement is tantamount to telling management that Adidas does not care one way or another if the 33 Perbupas leaders are reinstated. It is the WRC's strong recommendation that Adidas should send a clear message to PT Panarub management that if the 33 workers are reinstated the plan to reduce orders will be called off.

In discussing the reasons for the order reductions with Adidas the WRC learned that code compliance is, for all intents and purposes, not a factor in Adidas's decisions about where to source their products. Top Adidas representatives stated clearly that, "business decisions cannot be driven by compliance performance." This statement is surprising not only because it runs contrary to the two years of compliance work by Adidas and the WRC at PT Panarub, but also because it contradicts Adidas's own claims about their Standards of Engagement (SoE) (essentially Adidas's "code of conduct") on their website:

"These are the core values of the Adidas Group. We measure ourselves by these values, and we measure our business partners in the same way... The SoE is a tool that helps

us choose and retain business partners who follow workplace standards and business practices consistent with our policies and values.”

http://www.Adidas-group.com/en/sustainability/suppliers_and_workers/code_of_conduct/default.asp

The WRC has also received credible information that Adidas has asked PT Panarub to take a 3% price cut next year, and likely another price cut the following year, making it substantially more difficult for PT Panarub management to negotiate better labor benefits with the two legally registered trade unions at PT Panarub. If true, this price pressure would also serve as a strong disincentive for PT Panarub to comply with recommendations for reinstatement of the 33 Perbupas leaders and code standards around freedom of association and collective bargaining going forward – since constructive labor relations and meaningful collective bargaining necessarily result in at least modest increases in labor costs and, hence, production costs. Adidas should send a clear message to PT Panarub management that if the 33 workers are reinstated Adidas will pay a price adequate to meet the costs of full code compliance.

Summary of Remedial Actions Necessary at This Time

In order to address the above-mentioned violations, it will be necessary for Adidas to press PT Panarub management to take the following steps:

1. Offer immediate and unconditional reinstatement (with full back pay and to their original positions and level of seniority) to the 33 workers terminated in October, 2005. *Given PT Panarub's intransigence to date on this issue, it will be necessary for Adidas to make clear that future business relationships hinge upon the factory's compliance with this remedial step. At the same time, if PT Panarub does comply and reinstates the 33 employees, Adidas must be prepared cancel their plans to significantly reduce orders and prices.*
2. Begin good faith negotiations with the two unions in the factory (Perbupas and SPN) to identify a mutually agreeable way to conduct a union membership verification exercise.