WORKER RIGHTS CONSORTIUM

To: WRC Affiliate Colleges and Universities
From: Scott Nova, Worker Rights Consortium
Date: October 10, 2006
Re: Update on Hermosa/Chi Fung (El Salvador)

This memo provides a detailed update concerning the case of workers formerly employed by the Hermosa Manufacturing facility in Apopa, El Salvador, a supplier of university logo goods prior to its closure in May 2005.

Unfortunately, we must report that there has not been meaningful progress with respect to any of the key issues involved in this case, which include non-payment by Hermosa of legally mandated terminal compensation and back wages and illegal blacklisting of the concerned workers by another supplier of university logo goods located near Hermosa, known as Chi Fung. Indeed, given the considerable amount of attention this case has received in the seventeen months since the closure, the lack of substantial progress on any of the key issues reflects very poorly on the compliance efforts of the licensees involved.

Both Hermosa and Chi Fung have had long-term relationships with key university licensees. Prior to its closure, Hermosa supplied collegiate logo goods to Russell and Nike and non-logo goods to adidas.[1] Russell has acknowledged production in the factory up until shortly before the closure. Nike has asserted that it has not placed production in Hermosa since mid-2003, except for a brief order in July 2004. Adidas has asserted that orders were last placed at the factory in mid-2002. However, we believe – based upon consistent testimony from workers following the closure and upon research conducted by another NGO during 2004 – that production for Nike and adidas took place throughout 2004 and that the production of adidas goods continued until early 2005. These orders were very likely subcontracted by Chi Fung to Hermosa on an unauthorized basis, consistent with a long-standing practice of order sharing between the two factories. Chi Fung is a current supplier of collegiate logo goods for Nike and Jansport (owned by VF Corporation), as well non-logo goods for adidas.[2]

This update summarizes developments in the following areas: non-payment of legally mandated compensation by Hermosa; failure by Hermosa to remit employee pension and health care deductions to appropriate agencies; blacklisting of former Hermosa workers by Chi Fung; and follow-through on actions promised by licensees with respect to access to health care and job placement.

For additional information, I would encourage you to review the FLA's recently published reports on the Hermosa case on the FLA website.

[1] While we did not identify information indicating that the production of adidas goods at the Hermosa and Chi Fung facilities was collegiate licensed, we worked most closely with adidas on both the Hermosa and Chi Fung cases. Adidas acknowledged that its own corporate code of conduct applied to the factories and stepped forward from the outset in responding to the WRC's requests for intervention. The other licensees involved with the Hermosa and Chi Fung cases, including Nike, Russell Athletic, and VF Corporation, indicated that they were working collaboratively with adidas; Nike indicated to us that adidas was representing its position on the situation. It also bears noting that university factory disclosure data also indicated historical licensees LogoAthletic, Majestic Athletic, Louisville Golf, as well as Jansport and Lee Sport (both owned by VF Corporation).

[2] Of the two other licensees listed in university disclosure data, Team Edition Apparel reported that the disclosure data was faulty and that they had not been in the factory for many years, while Page and Tuttle did not respond to our inquiry.

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Unpaid Compensation

The issue of greatest concern involves compensation owed to former Hermosa workers. As we have reported previously, the Hermosa factory closed in May 2005 without having paid workers legally mandated severance and back wages. At the time of the closure, there were roughly 260 workers employed at the plant. It has been estimated that the total sum owed to all workers for severance, unpaid salaries, and unpaid benefits is roughly $825,000.[3]

Information available on the amounts owed to workers is most precise with respect to a group of 63 workers who, as part of various efforts to secure unpaid compensation, sought representation by a respected Salvadoran labor lawyer and pressed for criminal charges against their former employer.[4] The workers' legal counsel, Zoraida Rodríguez, has developed detailed information on the compensation owed to each of the 63 workers. According to this data, the workers are owed, in total, $114,926.52 in unpaid compensation and benefits (including back wages, production bonuses, accumulated vacation, accumulated sick leave, and annual bonuses) and $49,650.55 in unpaid severance. On average, the workers are owed $2,612.33 each, with individual totals ranging from $1,568.20 to $6,045.70.

There has been no progress on the payment of this compensation. In the months following the closure, discussions between representatives of the factory, the Ministry of Labor, and workers focused on the possibility of reopening the Hermosa factory, with income generated by the factory to be used to pay off the debts. This prospect was abandoned following a multi-stakeholder meeting at the Salvadoran Ministry of Labor in late January 2006 when it became clear that the factory's debts could interfere with a potential reopening and that the brands that had sourced from Hermosa did not support reopening the factory because the facility had failed to meet their quality standards.[5]

Discussions then turned to the prospect of paying off the debt through the liquidation of Hermosa's assets. In February of this year, representatives of adidas and Russell conveyed to the WRC that this prospect was the focus of their work and that they were making efforts to persuade Hermosa's principal creditor, Banco Cuscatlan, as well as several other banks, to relinquish some or all of their claims on Hermosa's assets so that funds could be directed to the concerned workers. At the request of Russell's legal representative, the WRC contacted Banco Cuscatlan, urging the bank to accede to this request. It has since become clear that the funds generated by the sale of Hermosa's existing assets would not have been sufficient to cover the debts owed to workers even if the other creditors did forgo some, or all, of their claims on Hermosa assets. The factory's key machinery had been seized by one of the company's creditors prior to the closure and was being leased back to the company, while the factory building itself had been sold in July 2005; thus, neither was in a position to be liquidated. In any event, the banks have refused to relinquish their claims on any assets that Hermosa does still posses.

Given the lack of liquidation as a viable means of resolving the situation, various parties, including the workers themselves, have appealed to Nike, adidas, and Russell to accept some amount of responsibility for the debts owed to the workers. The brands have thus far stated that they are not willing to do so. As I have noted previously, brands are, in the WRC's experience, loath to accept responsibility for debts owed by their contracted suppliers. Unlike some other regulatory regimes covering the apparel industry – such as those established by the California Labor Code and the U.S. Department of Labor, which require apparel brands to assume responsibility for a share of

[3] This estimate has been reported by GMIES, the monitoring organization contracted by adidas to investigate the case, as well as by the Fair Labor Association, various brands involved, and is consistent with the more specific information the WRC has reviewed with respect to the sub-group of the 63 former Hermosa workers.
[4] Note that this group of workers has also participated in various protest activities concerning Hermosa's practices and is the subject of the blacklisting discussion below.
[5] For background, see: "Informe de las Gestiones del Grupo de Monitoreo Independiente de El Salvador (GMIES) en el Caso Hermosa," August 23, 2006.

unpaid wages and overtime owed to workers employed by their contracted suppliers[6] – university codes of conduct do not explicitly require that licensees accept responsibility for compensation owed to workers by their supplier firms. Thus, even if licensees have contributed to the problem by failing to detect or remediate inappropriate financial practices despite multiple audits of the factory, there is presently no legal obligation on the licensees' part to contribute financially to settle the debt owed to the workers.

In a letter sent on April 26 by a committee representing former Hermosa workers to the brands involved – adidas, Nike, and Russell – the workers asked the brands to create an emergency fund to provide compensation owed to them. The WRC has also encouraged the brands to take this approach, as have others involved in this case, including the independent expert commissioned by the FLA to assess the case[7] and such an approach is suggested in the FLA's interim report recommendations. It remains to be seen whether the brands involved or the FLA may move forward with such a plan.

Pension and Health Care Funds

A separate issue concerns funds owed by the Hermosa factory to various government agencies. These include legally mandated contributions to the Salvadoran National Social Security Institute (INSS) and several government-contracted employee pension funds. In total, it is estimated that the company owes roughly $350,000 to these agencies.[8] This includes $133,326.43 owed to the INSS and $220,648.40 to the employee pension funds.

With respect to the health care payments, the INSS reported in August 2005 that Hermosa failed to pay legally required contributions during each year from 1996 through 2002 and then again in 2004. Thus, while there may be some dispute surrounding whether or not individual licensees were present in the factory during periods in which the facility failed to provide employees full compensation, there is no dispute that each of the key licensees were present in the facility during the period in which the pension and health care violations were occurring. In some cases, Hermosa failed to remit contributions to Salvadoran health care and pension funds deducted from employee paychecks. In some instances, Hermosa reported the amount owed to the government, but did not make a payment in this amount. As a result of Hermosa's failure to pay legally mandated contributions to the health care system, employees were unable at various times during their employment to obtain care at government health care clinics operated by INSS.

In November of 2005, following a legal complaint from workers, federal authorities arrested Hermosa's owner, Salvador Montalvo Machado, charging him with unlawfully failing to make payments to the health care and pension funds. He was released immediately on bail and faces trial. After substantial delays, the initial hearing took place on September 1st of this year; a formal trial was ordered to begin on October 11. It is important to bear in mind that the criminal trial involving Hermosa's owner does not address the failure by the factory to pay compensation and benefits to workers. Thus, even if Mr. Montalvo is found guilty, this would have no bearing on the unpaid severance and back wage claims described in the preceding section.

Blacklisting

As we have reported previously, the WRC has documented unlawful discriminatory hiring practices directed against former Hermosa workers by another supplier of collegiate logo goods, located near Hermosa in the town of Apopa, known as Chi Fung. The discrimination has been targeted against the group of sixty-three former Hermosa workers who have participated in

[6] See, for example, California Labor Code (Article 2673) and the Department of Labor's "Augmented Compliance Program Agreement" (Section 8).
[7] See Attachment B of the FLA Independent Expert Report, by Roberto Burgos Viale of the Central American University Institute of Human Rights.
[8] These figures have been reported by a credible Salvadoran newspaper known as Diario de Hoy and by the workers' legal counsel. We have not been able to obtain government documentation certifying the numbers.

protests against Hermosa's practices and pursued claims in Salvadoran courts against its owner. The evidence gathered by the WRC indicated that blacklisting involved explicit statements by hiring personnel to former Hermosa applicants among the pool of sixty-three workers to the effect that the factory would not hire former Hermosa applicants from this group. The blacklisting was achieved in part through the requirement that applicants produce a letter of recommendation from a former employer, known as a *constancia*, which effectively ruled out all former Hermosa applicants who had protested Hermosa's practices, since Hermosa management refused to provide a *constancia* to any of these workers.

Unfortunately, I must report that the licensees have not remediated the discrimination that has occurred. The licensees have been slow to act and the actions they ultimately took have fallen short of what was needed to effectively address the blacklisting issue. To date, *none* of the sixty-three workers from the targeted group have been hired at Chi Fung, despite a number of them having applied multiple times.

Our findings and recommendations for corrective action were reported in a detailed memo to adidas, Nike, and VF on April 20 of this year; a similar memorandum was subsequently shared with affiliate universities. We have since had numerous discussions and communications with adidas, which has taken the lead on this issue, and to a lesser extent with VF and Nike. When contacted regarding the blacklisting issue, Nike declined to participate in substantive discussions with the WRC, indicating that it was working together with adidas and that adidas was representing its position on the issue. VF has also generally supported the steps advocated by adidas and reported it was working with adidas on these measures.

After the WRC brought evidence of blacklisting by Chi Fung to the attention of the licensees, adidas proposed a series of steps to address the issue. These steps focused on altering Chi Fung's hiring process – such as recording the names of all applicants at the beginning of the application process and eliminating the requirement for a letter of recommendation – which adidas argued would provide better documentation of the hiring process and eliminate the potential for discrimination to occur.

We communicated to adidas that their approach was, in our view, inadequate to address the past and ongoing discrimination – for several reasons.

First, Chi Fung had demonstrated a clear desire to deny employment to the workers in question, regardless of their qualifications, and to use subterfuge to achieve this goal. While prohibiting Chi Fung from requesting *constancias* deprived the factory of one mechanism for discriminating against these workers, adidas' approach failed to close off another major avenue. Adidas did not require that Chi Fung make offers of employment to former Hermosa workers who were deemed qualified for open positions; they required only that Chi Fung "consider" these workers for employment. This allowed Chi Fung to deny employment even to those workers it might admit were qualified, by simply hiring other qualified workers instead. Moreover, adidas rejected the WRC's repeated requests that independent observers trusted by the workers be allowed to observe the hiring process, to ensure that discrimination did not occur. Instead, adidas insisted that only Salvadoran government officials (in whom workers place little trust), and individuals paid by adidas, would be granted access to the factory. Ultimately, adidas only agreed to provide the WRC access to the worksite until more than four months after we contacted them about the blacklisting issue, by which time monitoring of the hiring process was largely moot, and then only in the company of a monitoring organization contracted by adidas. In other words, adidas continued to allow Chi Fung to maintain a large degree of discretion in the hiring process for these workers, despite the fact that Chi Fung had repeatedly demonstrated that it would abuse its discretion for the purpose of blacklisting.

Second, because a number of the former Hermosa workers had already been blacklisted by Chi Fung, in response to their good faith efforts to seek employment, the group of workers as a whole was very suspicious of Chi Fung's intentions and many were disinclined to subject themselves to

a hiring process they had ample reason to believe would provide them with nothing but additional humiliation. For this reason, it was necessary for adidas, and Chi Fung, to communicate clearly to these workers that they were welcome to apply, that they would not be subject to any discrimination, and that they, as qualified applicants, could expect to receive job offers. It was also necessary to allow independent observation of the hiring process, not only to keep Chi Fung honest, but to reassure the workers. During the key period following revelation of the blacklisting problem, adidas took none of these steps, and ultimately provided only a terse and belated communication to the workers that did nothing more than inform them that they could apply for a job if they wanted to.

The most appropriate remedial action in this case, as recommended by the WRC, was for adidas to require Chi Fung to extend offers of employment, for any open positions, to the group of former Hermosa workers that had been targeted for discrimination – without requiring them to go through the hiring process. All of these workers had been employed at Hermosa and had therefore demonstrated their qualifications. There was no need to subject them to a hiring process that simply provided an opportunity for Chi Fung to victimize them again. Failing that, an alternative, though less effective, measure was for adidas to require Chi Fung to hire the workers on a priority basis – meaning that, if deemed qualified by Chi Fung, each former Hermosa worker would be offered any open position before it would be offered to any other applicant. However, adidas refused to adopt either of these recommendations. Instead, they insisted that the workers apply for positions and left it up to Chi Fung to pass judgment on their qualifications and to decide to extend, or refuse, a job offer to any of the workers the factory did deem qualified. Adidas insisted that workers go through a hiring process that was not necessary to determine their qualifications, while refusing to take the steps necessary to ensure the fairness of that process. And adidas further insisted that Chi Fung retain the right to deny employment, even to those Hermosa workers who might survive that process. These actions, combined with adidas' refusal to extend a meaningful invitation to the workers to apply at Chi Fung, effectively guaranteed that remediation would fail.

It is important to note in this regard that it would have been reasonable to expect adidas to ask Chi Fung to hire the former Hermosa workers on a priority basis even if there had been no evidence of blacklisting. Given the failure of adidas and the other licensees to achieve remediation of Hermosa's non-payment of severance and back wages to these workers, asking other suppliers over whom the licensees had influence to hire the workers was one available means to compensate them. This is a step licensees and other brands have not only been willing to take in other cases, but one they themselves have sometimes initiated without any prompting from monitors. Given that the former Hermosa workers were not only victims of Hermosa's financial malfeasance, but were also blacklisted by Chi Fung, requesting that Chi Fung hire the workers on a priority basis was, for lack of an appropriate technical term, a "no-brainer." In view of the circumstances, we find adidas' stubborn refusal to take this step inexplicable.

In April, adidas and VF initially agreed to the recommendation that Chi Fung provide priority hiring to the former Hermosa applicants, though it objected to the WRC playing a role in monitoring the process. However, following the initial discussion, adidas informed us that it would not in fact support a priority hiring arrangement. Instead, it reported it would go ahead with Chi Fung on the steps it initially proposed. These entailed asking the company to give fair consideration to any future former Hermosa applicants, but did not entail adidas or Chi Fung taking any pro-active efforts to encourage the workers to apply or to give priority to their applications. Adidas also announced it had asked that the Salvadoran Ministry of Labor serve as the official monitor of the hiring process, a scenario the WRC found to make little sense in light of the Ministry's poor track record on labor rights generally and in this case in particular.

Since adidas announced hiring process changes at Chi Fung in May, there has been limited opportunity to test the effectiveness of the approach, since under these adverse circumstances only six former Hermosa workers from the group of sixty-three have sought employment at Chi Fung (the most recent group of three workers on August 14). None of the six have been hired.

Without access to the factory premises and records, the WRC has not been able to conduct a thorough examination of each case. We have confirmed that, while some elements of adidas' remedial approach have been adhered to – including the elimination of the letter of recommendation requirement – there have been numerous irregularities in these cases. These have included a failure by the factory to allow some workers to fill out application forms or leave their names, an instance of a manager aggressively interrogating a worker about the names of any workers at Chi Fung whom they personally knew, and requiring workers to undergo testing on machines that they have already informed management are not within their field of experience. When we notified adidas that the rules of the new system were apparently being violated, adidas took no action, but instead reassured us that they believed the process was in fact operating effectively.

In light of the concerns about the small number of workers who had applied and their application experience, in August the WRC again communicated its concern to adidas regarding the factory's practices and reiterated our recommendation that the licenses and the factory take a more pro-active approach in addressing the discrimination by inviting workers to apply for work and providing them with priority consideration. During a phone meeting in September, adidas expressed agreement for a form of priority hiring for the concerned workers, with details to be worked out. However, adidas subsequently wrote that that it did not in fact support any form of priority hiring – the second time adidas agreed to support priority hiring and then reversed its position.

Nonetheless, a tentative agreement was reached with adidas on a new set of steps to address the blacklisting issue, wherein there would be no priority hiring commitment, but monitoring of the hiring process would be conducted jointly by the WRC and GMIES, a monitoring organization contracted by adidas, and adidas would provide workers with a letter of invitation conveying information about the hiring process and information about available positions. Following these discussions, on September 11, adidas circulated a letter titled "Notice to Workers", which outlines in some detail Chi Fung's hiring process, but unfortunately did nothing to actually encourage workers to apply.

It has since become clear that the measures tentatively agreed to will not lead to meaningful progress. On August 22, a committee representing former Hermosa workers replied to adidas' letter. The workers' communication conveys anger at the lack of progress on severance and health care, states that the workers do not regard the hiring policies described by adidas as meaningful or adequate, and makes clear that they will not pursue employment at Chi Fung. The final paragraphs of the letter read:

> "We want to make very clear to you that we do not regard the letter you have sent and the information it contains as an appropriate remedy for the discrimination we have suffered at your factory, Chi Fung, when we applied for employment on past occasions. Under these conditions, we do not have any plans to again seek work at the Chi Fung factory and risk again the wasted time, effort, and humiliating treatment, as has occurred on the past occasions we have applied for work.
>
> If at some point, if you wish to provide us with an assurance that we may find employment there or at another factory that works for adidas, that is accessible to our homes; or that you are taking some action to ensure that our severance and pending wages for the work we have performed for your company are paid; we will be glad to hear from you again." (WRC translation)

Given that this group of workers, whose situation the proposed steps were motivated to address, have now rejected participation in the process, it has become clear that it would not make sense for the WRC to go forward with and expend additional resources on these steps. Having discussed the issue numerous times with adidas, and to a lesser extent with other licensees, there does not appear to be any prospect of the licensees altering their position in a substantive

way. We are disappointed that that a more positive outcome could not be reached on the blacklisting issue and are discouraged that licensees have not chosen a more constructive and pro-active approach in this case.

Follow-through on Health Care and Job Fair Commitments Reported by Licensees

In April of this year, adidas and Nike reported in a series of public communications that they had secured a number of commitments by the Salvadoran government on specific action steps to address the Hermosa case. The two commitments which would have directly benefited the former Hermosa workers concerned access to health care, as well as invitations and priority treatment at a job fair.

With respect to health care, the licensees reported that the Salvadoran government had specifically committed to provide health care coverage to Hermosa workers and family members for one year (or until re-employment). The health care was to include both basic medical coverage, as well as the substantially more extensive so-called "catastrophic" health care for workers and family members through the National Social Security Institute (INSS). Access to this health care would have been of substantial significance to the workers in question, many of whom, as noted, were unable to obtain health care at various points during their employment at Hermosa and have had no access to meaningful health care since they were terminated roughly seventeen months ago. Unfortunately, the commitment reported by the licensees has not been fulfilled. Adidas reported to the WRC in June that the government has affirmed its pledge to provide the workers with access to the superior INSS system, but has been unwilling to provide workers with the documentation the workers would need to access this service. Government officials have since told workers that the only form of health care to which they will have access is to the most basic form of a walk-in clinic, to which they already have free access and which are widely seen as providing inadequate care owing to widespread staffing and medication shortages.

With respect to the job fair, the licensees reported on a commitment made by the government to invite former Hermosa applicants to a job fair to be held May 12-13 and provide them with priority for interviews and employment opportunities. The job fair never materialized. Workers were called to a meeting around those dates, during which they were provided the opportunity to fill out informational forms with their names, contact information, and work history. These documents were to be presented by the Ministry to various employers. However, when it was clarified that few or none of the employers included in the process included garment sector employers, the industry for which the workers are trained and wished to continue working, but instead included lower pay sectors, such as housecleaning and bakery work, the workers expressed discouragement and few, if any, pursued the application process.

Conclusion

In summary, there has been no meaningful remediation of any of the multiple code of conduct violations to which the former Hermosa workers have been subjected. They have been denied compensation they are lawfully owed – in amounts that have enormous financial significance for these individuals and their families. And they have been denied the right to fair treatment as job applicants at another apparel production facility that represented their best option for employment after Hermosa's closure. The actions of adidas, Nike, Russell, and VF in this case have been inadequate, both with respect to the violations at Hermosa and those at Chi Fung. Adidas' mismanagement of the remediation effort at Chi Fung is particularly objectionable, since correcting the blacklisting violations at this factory was well within adidas' power and would have at least made a modest contribution to righting the multiple wrongs this group of workers has suffered.