WORKER RIGHTS CONSORTIUM

WORKER RIGHTS CONSORTIUM REPORT
re PT KIZONE (INDONESIA)

STATUS UPDATE

May 15, 2012

I. Introduction

This document provides an update concerning the case of PT Kizone, the collegiate factory in Tangerang, Indonesia, where 2,686 workers were denied $3.4 million in legally mandated compensation, beginning on September 3, 2010. For the WRC's findings and recommendations concerning this case, and detailed background information, please see our Factory Assessment Report of January 18, 2012.[1] As we have previously reported, after partial payments by several buyers, the workers are still owed US$1.8 million.

Adidas is the only university-connected buyer at PT Kizone that has refused to pay funds toward making the workers whole. We continue to hope that adidas will revise its position; if this does not occur, there is no realistic prospect that the workers will ever receive the remainder of the money they have legally earned.

This report provides information concerning the following:

- The status of bankruptcy proceedings, including the decision of the bankruptcy court to make a financial allocation to the workers which represents only 21% of their legal due and the decision of other creditors to challenge this allocation in the Indonesian Supreme Court, which will prevent the timely payment of even this modest sum.
- The distribution to workers of US$55,000 contributed by the Dallas Cowboys.
- The actions and claims of adidas, including an analysis of the steps adidas says it is taking, a review of the outcomes in four prior cases in which adidas has adopted a similar stance, and an assessment of a number of unusual arguments that adidas has made concerning the obligations of licensees under university codes of conduct.
- The current situation of the PT Kizone workers and their families, who are suffering a variety of hardships, including loss of education opportunities for children, declining nutrition, and the accumulation of large amounts of debt.

II. Bankruptcy Proceedings

Recent legal developments have served to confirm what we have previously reported to you concerning the bankruptcy process: at best, workers will receive only a modest portion of what they are owed, and there is a substantial likelihood that they will receive nothing.

The amount provisionally awarded to the workers by the bankruptcy court represents only 21% of the workers' original legal entitlement of US$3.4 million and 39% of the US$1.8 million still owed to them after payments made by Nike, Green Textile, and the Dallas Cowboys. On January 19, 2012, the court-appointed receiver charged with allocating the funds obtained in the sale of

[1] *See,* http://www.workersrights.org/Freports/WRC%20Assessment%20re%20PT%20Kizone%20(Indonesia)%201-18-12.pdf. Dollar figures in this paragraph are as per the currency conversion rates described in this report.

Kizone's assets made an initial proposal: He proposed that the workers receive 3.5 billion Indonesian Rupiah (Rp) (US$385,000)[2] and that the majority of the proceeds of the asset sale be used to pay back secured creditors (a bank and a venture capital firm); significant funds also were allocated to various debts to government entities. On February 23, 2012, worker representatives attended a hearing at the Central Jakarta Commercial Court where the judge supervising the receiver heard and responded to challenges from the various creditors. After this hearing, the judge increased the allocation to the workers to Rp 6.4 billion (US$703,000), as stated in a written decision issued on March 7, 2012. If this amount is paid, the workers will still be owed $1.1 million.

Unfortunately, the workers may not receive even this amount. Several creditors, including Bank SBI Indonesia and a government tax office, have appealed the bankruptcy judge's decision to the Indonesian Supreme Court. SBI Indonesia is alone owed more than the entire amount raised by the sale of the company's assets. If the Supreme Court decides to prioritize the company's debt to this bank – and precedent suggests this is the most likely outcome – workers will receive no funds at all.

Moreover, the workers will likely have to wait a long time for any resolution. The union has not been informed of a specific timeline for the Supreme Court's review of this case and Indonesian public interest lawyers have informed us that such cases can take years to resolve. When the Court does reach an initial decision, any of the parties can ask for a second high court review of the case, which can add more years of delay.

Thus, as we anticipated, the bankruptcy process will not contribute toward timely payment to workers of the compensation they are legally owed.

III. Distribution of Funds Provided by Dallas Cowboys

The US$55,000 pledged by the Dallas Cowboys has been successfully distributed to the Kizone workers. Given the small amount of funds involved, it was not feasible for the WRC to take responsibility for implementing or verifying this distribution; however, the WRC did observe the initial in-person distribution and we provide a summary of the process here.

Upon the recommendation of the DPC,[3] which handled the distribution, and the WRC, the Dallas Cowboys requested that the Legal Aid Institute of Bandung (LBH Bandung) provide technical assistance to the DPC and prepare the financial reporting.

[2] All currency conversions in this report use the April 5, 2012 rate, which was 9,105 Rupiah to the US Dollar, unless otherwise specified.

[3] As we have previously reported, the Branch Leadership Board (Dewan Pimpinan Cabang) of the workers' union (Serikat Pekerja Textil, Sandang dan Kulit), is the organization that is advocating for the PT Kizone workers. In this document, this body is referred to as the "DPC."

LBH Bandung coordinated with the union to publicize the distribution via text messages, banners, social media, and advertisements in local papers. These efforts were effective in making workers aware of the distribution.

The initial distribution took place on February 29 to March 2 of this year at the office of the DPC. The $55,000 had been converted to Rp 496 million, of which Rp 422 million was distributed during this period to 2,120 workers. The DPC thus reports that the great majority of workers have now presented themselves and claimed their payments.

The remaining funds (Rp 74 million) are allocated for the remaining workers, who can collect their portions from the DPC. Workers have 90 days following the initial distribution to do so. As per an agreement between the DPC and Dallas Cowboys, any funds that are not claimed in this time period will be dedicated to an advocacy fund to help workers secure their remaining unpaid severance and/or to a capacity-building program for workers who have not yet found new employment.

The high percentage of workers who made arrangements to collect the very small sums of money on offer is an indication of the dire financial circumstances in which workers find themselves. The average payment was about $21; there were hundreds of workers for whose payments were less than $10. Despite this, 80% of the workers made arrangements to collect their funds during the initial distribution.

IV. Continued Refusal to Remedy by adidas

Although Nike (directly and through payments made by its agent, Green Textile) has now contributed more than US$1.5 million toward making the Kizone workers whole, adidas continues to refuse to offer any financial assistance.

The steps adidas says it is taking do not address the code of conduct violations committed by its contractor. These steps, discussed below, will not cause the workers to receive any of the funds they are legally owed and thus will not in any way remedy the code of conduct violations. Even on their own terms, these steps have proven to be of little value to most workers.

These inadequate measures are, in fact, the same ones adidas has utilized in multiple previous cases in Indonesia in which its supplier factories closed down without compensating workers. Unfortunately, as discussed below, these measures failed in those cases.

Adidas' Response

As we reported in January, adidas has stated that it has taken two measures: 1) convening meetings of Indonesian and Korean government and industry officials and, 2) encouraging other adidas contract suppliers in the area to consider hiring former Kizone workers. Adidas has retained a firm called PT Lidi to facilitate this hiring.

As to the meetings adidas has convened, many months have passed since adidas announced this effort and it has not yielded any money for the workers. It is extremely unlikely that this will change.

Hiring programs, while they may be of significant benefit to workers, do not, even if they are successful, constitute a remedy for severance violations – because they do nothing to secure for workers any of the funds they are legally owed for the labor they have already performed. If successful, they enable workers to perform additional compensable labor, which is useful but not relevant to the severance violations. Thus, such programs should be pursued as a supplement to effective remediation of the severance violations, not as a substitute. Adidas, unfortunately, has offered their program as a substitute for meaningful action to make workers financially whole.

Even on its own terms, adidas' hiring program has had very limited effect. Out of nearly 2,700 former PT Kizone workers, adidas reports that 300 – 11% – were hired by other adidas suppliers. It is not clear how many of these workers gained new employment due to any effort by adidas, as opposed to simply applying for work of their own volition. It is also unclear how many of these workers are still employed, since worker testimony indicates that a substantial number were hired as temporary workers.

There have been several problems with adidas' approach to hiring.

First, adidas has not communicated effectively with many workers. In interviews conducted in April of 2012, more than six months after adidas' hiring activities began, many workers indicated that they have never been contacted by adidas or anyone acting on the company's behalf. Some workers reported that workers who had served at PT Kizone in a supervisory capacity had been called to a meeting by PT Lidi and advised to pass information along to their former subordinates; it appears this method was not fully effective.

A major problem has been adidas' refusal to work with the DPC, despite the fact that more than half of the Kizone workers have signed documents naming the DPC as their legal representative. Instead, adidas had implied, it has been communicating exclusively with the factory-level union, which, as we noted in our January report, has been discredited and has been abandoned by the majority of the workers. Adidas' failure to meet with the DPC demonstrates a lack of respect for workers' right to select their own representatives and has prevented effective communication with many workers. As one worker explained, given their experience to date, many workers are reluctant to give information to, or rely on representations from, persons acting at adidas' behest who refuse to communicate with workers' chosen representatives.

In addition, a number of workers report that they have been told of available jobs at factories very far from their homes near PT Kizone – often more than two hours away. To accept such jobs, workers would have to spend upwards of four and a half hours each day in transit and

devote a large portion of their modest earnings to transit costs. For many workers, particularly parents of young children, this is not a viable option.

Finally, some workers accepted jobs at adidas suppliers, but were informed by the factories that these were short-term contract positions, rather than regular positions like those they held at Kizone. Some reported that their new employers have refused to give them more than a three-month contract.

Thus, adidas has pursued an approach that cannot remedy the violations at PT Kizone and has made matters worse by carrying out these activities in a flawed manner.

Recently, adidas has stated that it is also working with PT Lidi to "assess workers' needs" and is considering some kind of limited food aid, exclusively for workers who remain unemployed. This plan, to pay PT Lidi to assess the workers' needs in order to determine whether to provide them with food aid, is inappropriate and a waste of funds. These workers earned sub-poverty wages when they *were* employed and then were denied the severance they were legally due. No research is necessary to ascertain that these workers are in financial need. If adidas wants to provide food aid to workers, it should do so – without delay and by working with workers' chosen representatives. Adidas has not indicated how much food it intends to provide, but it is clear that the value of this aid, assuming it is provided, will be small relative to the funds workers are legally due.

Adidas' Track Record Concerning Severance Payments at Indonesian Supplier Factories

The ineffectiveness of adidas' response is particularly troubling because adidas has been aware of this type of abuse, and its impact on workers and communities, for more than a decade. Adidas has incorporated specific guidance on issues related to termination and reduction of orders, and the job loss that may result, in its training materials for its Social and Environmental Affairs staff since 2001. Adidas states the following on its corporate website: "Our previous experience in dealing with closures and downsizing means that we have well-developed systems in place to monitor and manage such eventualities, including the impact on workers and local communities."[4]

However, while adidas has long been aware of the risk that workers will be denied legally mandated compensation when factories close, the company has not only failed to take effective steps to eliminate these violations but, when they occur, has repeatedly pursued the same inadequate response.

[4] Undated document posted on adidas Group website, "Responsible Management of Factory Closures and Downsizing." Accessed April 2, 2012; not available on adidas site as of May 15, 2012.

In our January 18 report, we described the denial of severance benefits to the workers at another adidas supplier, the Hermosa factory in El Salvador, which shut down in 2005. Since then, we have collected information concerning adidas' response in four other cases involving supplier factories that closed without paying legally mandated severance to workers – all located in the same region of Indonesia as PT Kizone.

All four businesses,[5] collectively employing more than 20,000 workers, closed without paying legally mandated severance to their employees. In three of the four cases, adidas was the exclusive or primary buyer from the factory. To our knowledge, only workers at one factory, PT Dong One, received their legally mandated severance pay – and this was because of action by other buyers, not adidas.

PT Spotec and PT Dong Joe, two large footwear factories located in Tangerang, shut down in November 2006, owing their workers unpaid wages and severance benefits.[6] In total, 10,500 workers at these two factories were denied legally mandated compensation.

Both PT Spotec and PT Dong Joe had supplied shoes to adidas, as their sole customer, for more than a decade. Observers reported at the time that both closures appeared to be related to fluctuations in adidas' orders to the factories.[7]

According to media reports, PT Dong Joe owed workers Rp 95.2 billion (US$10.6 million)[8] at the time of closure. PT Spotec estimated its debt to workers at Rp 19 billion (US$2.1 million); given the number of workers involved – 4,500 – this was surely a low estimate.[9]

At that time, adidas had been assuring stakeholders that, "In the case of retrenchments, the adidas Group requires suppliers to have in place a viable plan to manage worker severance pay and benefits."[10] Then, as now, adidas' requirements clearly failed to compel the owners to set aside funds in a secure manner to meet their severance obligations to workers.

Adidas' response to the violations is instructive. Over four years of correspondence with worker rights organizations regarding PT Spotec and PT Dong Joe, adidas repeatedly refused to pay any funds to the workers; instead, the company identified measures very similar to those it says it is employing in the PT Kizone case. Adidas stated that it was addressing the violations at PT

[5] One of these factories, PT Dong One, was a collegiate supplier for adidas. The others were footwear factories and did not produce collegiate apparel.
[6] "Reebok maker owes billions to employees," *The Jakarta Post*, April 17, 2007.
[7] *See, e.g.,* correspondence from Oxfam Australia to adidas dated September 3, 2007, available at https://www.oxfam.org.au/wp-content/uploads/2011/08/oaus-3sepoausadidas-0708.pdf, and Oxfam Australia, "Inside adidas' Indonesian factories," available at https://www.oxfam.org.au/explore/workers-rights/adidas/inside-adidas-indonesian-factories.
[8] "Reebok maker owes billions to employees," *The Jakarta Post*, April 17, 2007.
[9] "Pesangon 4,500 Buruh Spotec Tidak Jelas," *Tempo Interaktif*, November 17, 2006.
[10] "adidas Group response to the report 'Sector-Wide Solutions for the sports shoe and apparel industry in Indonesia' published by Oxfam Australia and the Clean Clothes Campaign." Document released by adidas on April 25, 2008.

Spotec and PT Dong Joe by: 1) convening meetings with the Indonesian and Korean governments; and 2) arranging for workers to receive priority in hiring at other adidas suppliers, including the new firm that took over the PT Spotec site.

The result of adidas' approach in those cases was that workers never received more than a fraction of the amount due to them by law. Adidas' diplomatic efforts had no apparent effect. This was likely unsurprising to adidas: according to a U.S. Department of State cable dated January 4, 2007, adidas indicated early on to the U.S. government that it was not optimistic that efforts to hold the owner accountable in Korea would succeed. The workers at both factories pursued their severance through the courts, but failed to secure most of what was owed them. A leader from the union representing the workers informs the WRC that, as of the present date, more than five years since the closures, the PT Spotec workers have received less than half of what they were owed and the PT Dong Joe workers an even smaller percentage.[11]

Adidas' jobs program in these two cases had only limited impact, producing jobs for less than 20% of the former workers. 8,500 workers received no benefit from these efforts, despite the fact that the PT Spotec factory was purchased by another firm, was re-opened as PT Ching Luh, and began to produce for adidas.[12] Adidas itself stated: "The total number of job openings [at PT Ching Luh] continues to be small relative to the large number of workers who are seeking re-employment."[13]

A third adidas supplier, PT Tong Yang Indonesia,[14] ceased production shortly after PT Spotec and PT Dong Joe. After signing an agreement with workers that they would be placed on paid leave, PT Tong Yang reneged and ceased providing any salaries to its more than 9,000 workers. For eight months, the workers were left in limbo while the company unsuccessfully attempted to attract new investment.[15] In 2007, the factory officially closed its doors. According to newspaper reports, the workers ultimately received only a small portion of the amount due to them; these

[11] Adidas later stated that it provided some "humanitarian aid" to the workers; however, while the WRC does not have detailed information on what was provided, sources in Indonesia have indicated that it did not represent meaningful progress toward making these workers financially whole.
[12] "Adidas' broken promises." Post on Labour Behind the Label blog at http://www.labourbehindthelabel.org/join/item/757-adidas-promise-background. See also letter from Andrew Hewett to Herbert Hainer, October 7, 2010.
[13] Communication from adidas to Oxfam Australia dated June 22, 2007, posted at http://www.oxfam.org.au/site-media/pdf/OAus-22JuneAdidasToOxfamAustralia-0708.pdf.
[14] Tong Yang and Dong Joe had been the subject of an early Reebok social audit, *Peduli Hak: Caring for Rights*, in October 1999. At the time, Reebok noted that these two factories comprised 2/3 of Reebok footwear production in Indonesia (page 9). Reebok also noted that "management responses went beyond minimum requirements with a positive attitude and a commitment to make lasting improvements" (page 7). If, as was alleged by Oxfam Australia, the closure of these factories was due to fluctuations in orders after Reebok was purchased by adidas, the closures reflect poorly on adidas' commitment to reward this type of improvement.
[15] "Adidas Workers Cannot Seize Company's Assets," *Tempo Interactive*, September 3, 2007.

funds came from the sale of the factory's assets.[16] In this case, as in the others, adidas failed to pay funds to make the workers whole.

PT Dong One, an adidas apparel supplier factory disclosed as a collegiate facility, closed in early 2011 without paying its nearly 1,000 workers US$1.3 million in severance and other obligations.[17] Nike committed last year to pay 50% of this sum to the PT Dong One workers. Adidas paid nothing. Subsequently, Green Textile purchased the factory and agreed to re-employ all of the workers and reached an agreement with a union representing the workers to carry over their remaining severance in the form of severance credits under their new employment contracts. Neither adidas nor the workers have reported that adidas took any action to address the code violations in this case.

We have reviewed above the outcomes of four cases in which adidas suppliers in Indonesia closed without paying legally mandated compensation and in which adidas took the same approach it has informed universities it is taking at PT Kizone (or did nothing at all). Of the roughly 20,500 workers affected in these cases, 19,500 never received the bulk of their legally mandated compensation. The positive resolution that was achieved for the other 1,000 workers was the result of the efforts of other companies, to which adidas failed to contribute. Including the family members of those 19,500 workers, we can estimate that there are between 75,000 and 100,000 people whose well-being and life prospects have suffered severe harm as a result of adidas' failure to remedy unlawful actions by its suppliers. That is in a single country, one that represents a small fraction of adidas' global supply chain.

There is no reason to believe that adidas' response in the PT Kizone case will produce a better result than in the cases of PT Dong Joe, PT Spotec, PT Tong Yang – or the Hermosa factory in El Salvador. Nor is there any reason to expect that PT Kizone and PT Dong One will be the last instance in which workers making university logo goods are robbed of legally mandated severance by an adidas supplier. Indeed, without a change in the company's practices, it is virtually certain that more such violations will occur.

V. Increasing Debt and Financial Hardship among Workers

In a survey of former Kizone workers conducted in April, every worker questioned stated that he or she had incurred substantial debt since the factory closed. Suddenly losing a paycheck, without receiving the severance money that is intended to protect workers in this circumstance, has done severe harm.

One married couple, Heni and Entis, both of whom had worked at Kizone, serve as an example of the problems workers face. They report that they have incurred approximately Rp 6 million

[16] "Ratusan Mantan Karyawan Terima Pesangon," *Pikiran Rakyat*, July 7, 2008.
[17] *See*, WRC Memo, "*Workers at PT Kizone Still Owed $1.8 Million; No Action from adidas and Dallas Cowboys*," July 26, 2011, at http://www.workersrights.org/Freports/PT%20Kizone.asp.

(US$660) in debt to a neighborhood food vendor, to their landlord, and to family members. They have accrued this debt despite constant efforts to find work; the wife found temporary work at another garment factory, which subsequently closed, and the husband takes what work he can, sometimes unloading trucks for less than minimum wage. This couple had used the payment from Nike to pay a graduation fee charged by the vocational high school where their oldest child was studying automotive technology. If this fee is not paid, a student's diploma will not be released and he will not be able to market himself as a high school graduate. Virtually all Indonesian high schools, including public high schools, charge these fees, as well as monthly tuition fees and registration fees at the beginning of each level of school. Heni and Entis between them had worked at Kizone for 22 years, and the two together were owed Rp 40.8 million (US$4,500). Given that they have received approximately half of that amount to date, the family is still owed fifteen months' salary.[18] If they received that money, they could pay off their debt, pay for their second child to graduate middle school and begin high school, and still have some money to pay for their daily needs while they continue seeking work.

This level of debt is not unusual among the workers interviewed in April. Marlina is a widow with two children who worked at Kizone for eleven years. She recently found temporary work, on a three-month contract, at another apparel factory. However, it took her six months to find work and, in the interim, she incurred approximately Rp 4 million (US$440) in debt. She owes money to the neighborhood vegetable vendor, neighbors, the neighborhood rice vendor, and the vendor who sells gas for the stove. In addition, the well apparatus that supplies water to Marlina's house is broken, and she has no money to fix it, so she has no water and must go to different neighbors' homes every day to ask for water for washing and cooking. She estimates that it would cost Rp 4.5 million (US$500) to have a functional well apparatus again.

This debt has come despite Marlina's best efforts to live as frugally as possible. In listing the daily expenses for herself and her two sons, Marlina explained, "The important thing is to be able to have rice. Maybe we add some chili pepper, some salt, if we can. In terms of meat or tofu, sometimes we have it, sometimes we don't. If we can, we get prawn crackers and salt."

Last month, Marlina's son graduated from middle school. As the child of a widow, his graduation fee is waived. However, for him to continue his education, Marlina must find Rp 5 million (US$550) to pay for his high school registration, and monthly tuition for him as well as his younger brother.

If Marlina received the remaining severance due to her, she could pay her debts and pay her son's high school registration fee, with a small amount of money left over to support her if her current short-term contract job is not renewed.

[18] Calculated as per wage levels at the time of closure.

Most of the workers interviewed describe similar hardships – which will be substantially addressed if the workers are paid the money they legally earned.

VI. Licensees' Obligations Under University Codes of Conduct

Analysis of Code Requirements Concerning a Supplier Factory's Failure to Pay Severance Benefits to Former Workers

Based on the findings outlined in our prior reports, the WRC concluded that adidas has violated university codes of conduct by failing to take effective action to ensure that the former PT Kizone workers receive the severance compensation which they are legally owed. Adidas has not raised any credible questions about the WRC's factual findings. It has, however, contested the WRC's conclusion that it is in violation of university codes. Below, we address several of the unusual claims that adidas has put forward in recent months in defense of its refusal to help make the PT Kizone workers whole.

University codes require licensees to ensure payment of legally owed compensation, including severance benefits, to workers

Adidas Claims: Legally mandated severance benefits are not a form of compensation covered by university codes of conduct. University code requirements are limited to wages and non-cash benefits. Severance benefits are not a form of wages, because they are not "earned."

WRC Analysis: University codes of conduct typically require that factories which produce collegiate licensed apparel comply with all the national labor laws of the countries in which they operate.[19] Furthermore, university codes also typically contain a separate, free-standing, requirement that such factories pay their workers all legally mandated wages and benefits.[20] We do not know of any university codes of conduct that does not require a licensee to ensure either (1) compliance with all national labor laws, (2) payment of all legally required wages and benefits, or both (1) *and* (2).

As in many other apparel-producing countries, in Indonesia the payment of severance benefits to an employee upon termination is a requirement of the national labor law.[21] Severance benefits are funds payable to the employee by the employer by virtue of the employee working for the employer. If, as adidas appears to argue, severance payments are not a form of wages, then they

[19] Collegiate Licensing Corporation, *Special Agreement Regarding Labor Codes of Conduct* (Jan. 2008) ("CLC Special Agreement"), Schedule I, Art. II, A. ("Legal Compliance: Licensees must comply with all applicable legal requirements of the country(ies) of manufacture in conducting business related to or involving the production or sale of Licensed Articles.")
[20] Id. at Schedule I, Art. II, B. 1 ("Wages and Benefits: Licensees recognize that wages are essential to meeting employees' basic needs. Licensees shall pay employees, as a floor, at least the minimum wage required by local law or the local prevailing industry wage, whichever is higher, and shall provide legally mandated benefits.")
[21] Law on Manpower (Act No. 13 of 2003), Article 156.

must be considered a form of non-wage benefit, which, under university codes, licensees are still required to ensure are provided to workers.[22]

It is hard to believe that adidas is actually trying to argue that severance payments are some other form of compensation, that do not constitute wages or benefits, and therefore fall into a "black hole" not protected by university codes. Nike did not make this claim, either in this case or in regard to the Hugger and Vision Tex cases in Honduras, which also involved unpaid severance benefits.[23] Indeed, no licensee has ever made such a claim before.

There is no evidence at all that universities, in drafting their codes, intended to create a loophole for licensees and their supplier factories with regard to severance benefits. Indeed, university codes' explicit requirements that licensees ensure compliance with "*all* legal requirements of the country(ies) of manufacture" and provide "*all* legally mandated benefits" suggest precisely the opposite.

University codes hold licensees accountable for labor law violations by suppliers, even if the licensee is not the workers' direct employer

Adidas Claims: Indonesian law makes employers, not buyers, responsible for compensation owed to workers. PT Kizone, not adidas, employed the workers who are owed severance benefits. Under U.S. state laws, under which university licensing agreements are interpreted, adidas cannot be held responsible for compensating these workers because adidas never had an employer-employee relationship with them.

WRC Analysis: Since the inception of university codes of conduct, it is has been understood and universally accepted that the codes' standards, and a licensee's obligations to meet them, apply in the same way to contract factories as to factories owned by the licensee itself.

Like the broader U.S. retail apparel industry, the collegiate licensed sector consists mostly of firms that do not manufacture their own products, but instead rely on third party suppliers. Few among the top university apparel licensees actually operate their own factories or employ any garment workers themselves. If universities had not taken the position that licensees are responsible for code compliance by their contractors, the codes would have had no application to the factories where the overwhelming majority of collegiate licensed goods are produced.

Put simply, adidas' position would empty university codes of nearly all meaning and effect with regard to actually protecting the conditions of the workers who make collegiate apparel. Again, there is no evidence that universities ever intended to create such a glaring gap in their codes' applicability, nor that any licensee ever thought that it could rely on one. Adidas' claim in this regard simply lacks any precedent or justification.

[22] *See*, CLC Special Agreement, *supra,* at n. 12 ("Licensees . . . shall provide legally mandated benefits").
[23] *See,* Steven Greenhouse, "Nike Agrees to Help Laid-Off Workers in Honduras," *New York Times* (Jul. 26, 2010).

On the other hand, the principle that licensees *do* have an obligation under university codes to ensure compliance with the codes' standards by their third-party suppliers is explicitly recognized in the codes' definition of the term "Licensee." Many university codes state that "for purposes of the Code," the term, "Licensee" is defined to "encompass all of Licensee's contractors, subcontractors or manufacturers which produce, assemble or package finished Licensed Articles for the consumer."[24] University codes thus explicitly make the licensee responsible for protecting the rights of workers employed by its contractors, just as if these workers were the licensee's own employees.

The codes' requirement that "Licensees shall comply with all applicable legal requirements of the country(ies) of manufacture" and that they "shall provide [employees with] legally mandated benefits" to adidas with regard to PT Kizone – in exactly the same way they would apply if adidas employed the workers itself. If adidas wished to object to assuming this responsibility with regard to its suppliers' workers, the time to do so was when it was first asked by universities to accept their codes – not now, more than a decade later.

In this regard, there is no difference, from a code of conduct standpoint, between licensees' obligation to remedy severance violations and licensees' obligation to remedy any other type of violation. Licensees are rarely directly responsible for labor rights violations at a contract factory; the violations are committed by the contractor. Yet this does not in any way absolve licensees of the responsibility to address the violations. If a contractor illegally fires a worker, the licensee is responsible for ensuring reinstatement, even though the licensee did not make the decision to fire the worker. In exactly the same way, if a contractor fails to pay workers compensation they are legally owed (whether wages, overtime pay, severance or any other form of compensation), the licensee is responsible for ensuring that the workers are paid, even though it was not the licensee's decision to withhold payment. The only difference is that, in severance cases, circumstances sometimes arise in which the only way for the licensee to ensure payment is to pay the workers directly – something adidas clearly does not want to do. However, adidas' desire to avoid financial responsibility is not, under university codes, a legitimate basis for refusing to remedy labor rights violations.

<u>University codes require licensees to remedy violations at supplier factories --not simply to sever relationships with non-compliant suppliers</u>

Adidas Claims: Under university codes, adidas was only obligated to monitor PT Kizone and to refrain from placing new orders if the factory violated code standards. Adidas fulfilled this obligation with regard to PT Kizone because it monitored the factory and then did not place *new* orders with the factory after the severance violations began.

[24] CLC Special Agreement, Schedule I, Art. I.

WRC Analysis: Again, adidas' position is unprecedented, and, moreover, completely illogical. It has been generally understood by universities – and, until now, undisputed by licensees – that when violations of university codes are found at a third-party supplier to a licensee, the obligation of the licensee is to *remedy* the violation, by rectifying the harm to the factory's workers, rather than simply discontinuing the business relationship with the supplier.[25]

There are two chief reasons for why universities have taken this approach:

First, the primary purpose of university codes is to enable the university to conduct its licensing business in a socially responsible and ethical manner.[26] This purpose would not be served if the sole impact of the code's enforcement at factories that have violated the codes' requirements were for the factory to lose the licensee's business. Lengthy experience with the negative impact of such buyer actions on workers,[27] has led to widespread recognition that simply severing business ties is not an adequate response to a supplier's noncompliance. Instead, from the time of the initial adoption of university codes of conduct to the present, it has been understood that, when faced with violations of labor rights in a supplier factory, the responsibility of a licensee is to take effective steps to remedy these abuses, not to simply cease doing business with that supplier.[28]

Second, if licensees' only obligation were to refrain from placing new business at factories that violate worker rights, then licensees would have no incentive to effectively monitor labor rights compliance. Licensees could save money by using unscrupulous factories, and then, if abuses are exposed, simply finish their current business and move to a new supplier. Licensees would be free to shift business from one unscrupulous supplier to the next, always sharing in the cost-savings from labor violations, but never having to pay the price. Such an approach to application and enforcement of university codes would be contrary to their entire purpose and intent.

This is why, in cases where the rights of workers producing collegiate apparel have been violated, the licensee's responsibility is to remedy the violations – that is, to the greatest extent possible, to put the worker in the situation where she or he would have been if the violation had not occurred. In cases involving unlawful termination of employment, such as a discriminatory or retaliatory firing, remediation requires both compensation for loss of income (i.e., back pay)

[25] *See, e.g.,* Greenhouse, *supra,* at n. 15.
[26] CLC Special Agreement, Schedule I, Art. I ("[T]he collegiate institutions . . . are each committed to conducting their business affairs in a socially responsible and ethical manner.")
[27] *See, e.g.,* "Wal-Mart to Cut Ties to Bangladesh Factories Using Child Labor," *CBC News* (Nov. 2, 2005).
[28] *See, e.g.,* Greenhouse, "Rights Group Scores Success with Nike," *New York Times* (Jan. 27, 2001) (Nike and Reebok commit to maintain orders at collegiate supplier in Mexico and work to remedy violations of freedom of association.)

and reinstatement to the worker's original job.[29] In a case like the present one, where the employer has failed to pay legally mandated compensation to workers, the remedy is to ensure payment of the money that is legally owed.[30]

Adidas has asserted a very different interpretation of what university codes require. Its claim, apparently, is that when adidas discovers labor rights abuses at one of its suppliers' factories, it is not required to take any remedial action so long as adidas: (a) did not know of the violations at the time of placing its order with the supplier; and (b) does not place an additional order after it learns of the violations.

This is a truly radical interpretation of university codes. If universities were to accept adidas' position that licensees have no obligation to remedy labor rights violations – and can continue to use a factory that is committing such violations as long as no *new business* is placed – then not only would licensees be free of any obligation to undo even the most grievous harm done to workers by a supplier, they would be free to benefit from this harm for as long as it takes the supplier to complete a given order. For example, a licensee could place a large order at a factory for six months of production, learn weeks later from the WRC that the factory is using coerced and unpaid child labor, and then be perfectly within its rights to continue production for the entire six month period, benefiting from the cost savings, and then sell the clothes at a handsome profit. As long as the licensee did not subsequently place any new orders at the facility, it would have complied fully with university codes. This extreme scenario, which would be utterly intolerable to any university, is perfectly consistent with the interpretation of university codes of conduct that adidas has put forward in defending its refusal to remedy the severance violations at PT Kizone.

Licensees are responsible for remedying code violations at all suppliers of collegiate apparel, regardless of the volume of orders

Adidas Claims: Adidas' obligation to remedy the failure of PT Kizone to pay severance benefits to workers is somehow lessened because the factory produced only a modest number of garments for adidas after the violations began in September of 2010.

WRC Analysis: Under university codes of conduct, licensees are obligated to ensure respect for the rights of workers at all factories making collegiate apparel. The codes make no distinction based on how many garments a licensee is producing at a particular facility. We are unaware of any university that has ever exempted factories based on production volume and we are unaware

[29] *See,* Greenhouse, "Labor Fight Ends in Win for Students," *New York Times* (Nov. 17, 2009) (detailing agreement by Russell to rehire and compensate former employees in Honduras), at http://www.nytimes.com/2009/11/18/business/18labor.html?_r=2.
[30] *See,* Greenhouse, *supra,* at n. 15.

of any prior case in which a licensee has argued that a low level of production has material relevance to the question of whether the licensee is obligated to address violations at a given factory.

Yet adidas has repeatedly cited production volume data to argue that it has few or no code of conduct obligations at PT Kizone.

The reason why university codes provide no exemption for factories with low levels of production is straightforward: If licensees had fewer obligations under university codes at supplier factories that produce fewer goods, it would create a strong incentive on the part of licensees to distribute the production of collegiate apparel among its suppliers so widely as to be effectively exempted from the codes at most or all factories. Moreover, if codes actually varied in their applicability based on whether a particular supplier produced a particular volume of licensed goods, it would introduce a large element of factual uncertainty as to whether any factory manufacturing collegiate apparel was or was not covered by the codes.

Once again, universities have never given any indication that their codes should apply differently to a factory depending on *how many* collegiate license garments it produces, versus simply whether or not it is a supplier of collegiate apparel to a licensee. Instead, universities have treated their codes' requirements as applying to all factories that produce licensed garments for a given licensee. That is why universities require licensees to disclose the names and locations of all factories producing university goods, regardless of production volume.[31]

[31] CLC Special Agreement, Schedule I, Rider 1 ("Full Public Disclosure: Each Licensee shall disclose to the Collegiate Institution or its designee the location of *each factory* used in the production of *all items* which bear Licensed Indicia." (emphases added, parenthetical omitted)).