

# Emergency Assistance, Redress and Prevention in the Hermosa Manufacturing Case

Report prepared for the Fair Labor Association  
by the Maquila Solidarity Network (MSN)

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## **1. Introduction**

The closure of the Hermosa Manufacturing facility in El Salvador in May 2005 left former Hermosa workers without jobs, without back wages, without severance pay, without health insurance and without employee pensions. Workers have lost their homes, their health, and many – in particular those who had organized a union at the factory – remain unemployed to this day.

Brands and licensees who are members of the Fair Labor Association (FLA), and have therefore made a commitment to ensuring decent labour standards in their production facilities, were amongst the buyers who sourced apparel products at the Hermosa facility during the last five years of its operations. The closure is the subject of a third party complaint under the FLA Third Party Complaint system. As of the date of submission of this report, that complaint had not yet been closed.

On December 22, 2006, the FLA announced the creation of an Emergency Fund “to provide immediate and direct assistance to the [former Hermosa] workers while efforts continue to hold the government of El Salvador and the factory owner responsible for carrying out their legal obligations to the workers.”

As a condition of setting up the Emergency Fund, the FLA also committed to reviewing the impacts of the Fund and considering further measures to remediate the situation of the ex-Hermosa workers. In January 2007, the FLA contracted the Maquila Solidarity Network (MSN) to carry out this study as part of its review process.

## **2. Scope of the study**

Based on interviews with FLA participating companies, staff and NGO members, other companies that had sourced from the Hermosa factory in El Salvador, the organized ex-Hermosa workers, and the various international and Salvadoran stakeholders in this case, this study documents their different perceptions and concerns about what responsibilities buyers have in this case and in other situations in which a supplier fails to fulfill its legal obligations to workers, and the government fails to take appropriate steps to see that those obligations are met.

The study pays particular attention to the Emergency Fund established by the FLA to provide former Hermosa workers humanitarian assistance, documenting what it was and was not created to achieve, the perceptions and/or concerns of FLA members, the organized ex-Hermosa workers and other stakeholders about the fund, how it was implemented, what the impact has been to date, and the feasibility and desirability of such a fund being established on a more long-term basis.

The study also attempts to identify further steps that could be taken to rectify the injustices suffered by the Hermosa workers, and explores possible options, policies and procedures that buyers, both individually and as a group through the FLA or another entity, could put in place to minimize the possibility of similar situations taking place in the future.

### 3. Interviews conducted

MSN requested interviews with all the major stakeholders in the Hermosa case. MSN met with a group of 20 ex-Hermosa workers on February 24, 2007. We interviewed five members of the Executive Committee of the Ex-Hermosa Workers on February 28 and conducted follow-up interviews with four workers on May 11.

We were also granted interviews with the following individuals:

- Jeremy Blasi, Senior Field Representative, Worker Rights Consortium
- Daryl Brown, Vice President of Human Rights Compliance, Liz Claiborne
- Laura Carter, Assistant to the General Secretary, International Textile, Garment and Leather Workers Federation
- Napoleon Castellanos, Labour Practices Manager, Partex Apparel Intl.
- Franklin Chavarria, Social and Environmental Affairs Manager, Americas Region, Reebok/adidas Group<sup>1</sup>
- Christina Chung, Senior Staff Attorney, Asian Pacific American Legal Center
- Bob Durkee, Vice President and Secretary, Princeton University
- Fair Labor Association NGO caucus
- Danilo Ernesto Flores, Coordinador, Area de Defensa de la Constitucionalidad y los Derechos Humanos, Fundación de Estudios para la Aplicación del Derecho (FESPAD)
- Fukumi Hauser, Director of Compliance, Americas, Nike
- María Silvia Guillén, Directora Ejecutiva, Fundación de Estudios para la Aplicación del Derecho (FESPAD)
- Art Heffner, Executive Vice President, Logistics Services, Phillips-Van Heusen
- Frank Henke, Global Director of Social and Environmental Affairs, adidas Group
- HeeWon Khym, NGO and Trade Union Coordinator, Fair Labor Association
- Marcela Manubens, Vice President, Global Human Rights and Social Responsibility, Phillips-Van Heusen Corporation
- Marcelo Marquelli, Abogado Procurador, Area de Defensa de la Constitucionalidad y los Derechos Humanos, Fundación de Estudios para la Aplicación del Derecho (FESPAD)
- Tara Mathur, Field Consultant, Worker Rights Consortium
- Nayda Medrano, Coordinadora, Mesa de la Maquila
- Caitlin Morris, Compliance Director, Nike
- Gregg Nebel, Head of Social and Environmental Affairs, Americas Region, adidas Group
- Jorge Perez-Lopez, Executive Director, Fair Labor Association
- Maik Pflaum, Christliche Initiative Romero (CIR)
- Gustavo Pineda, former Coordinator, El Salvador Independent Monitoring Group (GMIES)
- Carolina Quinteros, Board of Directors, and Astrid Valencia, Director, El Salvador Independent Monitoring Group (GMIES)
- Lesley Roberts, Director Group Business Standards, Pentland
- Thomas Schupper, Social Responsibility Coordinator, Majestic Athletic
- Samantha Tate, Senior Program Officer, Americas Department, Solidarity Center
- Wen Ling de Tsai, Manager, Chi Fung S.A. de C.V.

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<sup>1</sup> Mr. Chavarria has since left this position.

- Auret van Heerden, President and CEO, Fair Labor Association
- Ivan Viera, Vice President, Social Compliance, Russell Athletic
- Rob Wayss, Country Programs Director for Central America, Solidarity Center
- Ineke Zeldenrust, International Coordinator, Clean Clothes Campaign

El Salvadoran and U.S. government officials familiar with the case were not available for interviews.

MSN would like to thank all of those who generously gave of their time to be interviewed for this study.

In this report we do not attribute comments to specific individuals or organizations except where it is necessary to give meaning to the comment.

#### **4. Summary of Hermosa Case**

The Hermosa Manufacturing case and the establishment of the FLA Emergency Fund has been well documented in a number of reports, including:

- FLA Interim Summary Report on the Third Party Complaint Regarding Hermosa Manufacturing, El Salvador, August 25, 2006
- FLA Independent Expert Report, Robert Burgos Viale, June 7, 2006
- Letter from the organized former Hermosa workers to the FLA, December 20, 2006
- Letter from FLA President Auret van Heerden to the organized former Hermosa workers, December 24, 2006
- Report Of Results Of The Process Involving Former Workers Of Hermosa Manufacturing Who Benefited From The Emergency Fund Of The Fair Labor Association, FESPAD, February 6, 2007

All of the above are available on the FLA website at [www.fairlabor.org](http://www.fairlabor.org).

The Worker Rights Consortium (WRC) has produced a report dated October 10, 2006, Update on Hermosa/Chi Fung (El Salvador), which is available at [www.workersrights.org](http://www.workersrights.org). Updates from the WRC dated December 15, 2006 and January 4, 2007 are also available.

In addition, MSN has reviewed a number of other notable reports, including:

- Hermosa Update, adidas, April 2006
- Informe de las Gestiones del Grupo de Monitoreo Independiente de El Salvador (GMIES) en el Caso Hermosa, August 23, 2006
- Clean Clothes Campaign update on Hermosa and FLA Emergency Fund (<http://www.cleanclothes.org/urgent/07-01-03.htm>)

As these reports document, during the five years prior to closing, Hermosa Manufacturing produced apparel products for a number of brands including adidas, Nike, Russell Athletic, Majestic Athletic, Reebok (now owned by adidas), Puma, Pentland, and Wal-Mart. Some of these products were subcontracted through the Partex Apparel Group, and some were sourced directly with Hermosa. There

is, however, some discrepancy in the reports and in stakeholder interviews regarding two factual matters:

- Whether goods were subcontracted to Hermosa from the nearby Chi Fung factory, which produces for a number of the same brands; and
- When the various brands were sourcing from Hermosa and when they stopped producing goods in the factory.

It's not possible within the scope of this study to draw any conclusions on either of those factual matters. However the fact that these questions are unresolved points to a need for brands to better track their own production and ensure that unauthorized subcontracting is not taking place.

The following basic facts were outlined in the FLA's Interim Report:

- The factory began to experience financial difficulties in 2004. The factory's owner, Salvador Montalvo Machado, failed to make legally-required payments to the social security and retirement funds of workers, although the owner did report the owed amounts to the appropriate government agencies.
- During late 2004 and early 2005, workers were asked to work Sundays in order to complete production for FLA and non-FLA member companies and were not paid for overtime work. They protested to the owner but did not get paid. A work stoppage occurred in early 2005, which ended when the factory owner and workers came to an agreement. The owner subsequently terminated the employment of the workers who led the stoppage.
- In April 2005, the union STITTAS, an affiliate of FENASTRAS, organized workers at the factory. When the union and the owner could not reach agreement on payment for Sundays worked, the unionized workers occupied the factory. The Department of Labor ruled the strike illegal.
- In May, the owner suspended commercial activities. Hermosa received a permit to temporarily stop its commercial activities, according to the government.
- The factory had no fund, accrual of money, or identified assets in its accounts to cover severance payments. Total worker compensation due, including unpaid benefits, unpaid salaries, and severance, is estimated at \$825,000.
- The factory owed approximately \$750,000 to the bank that held the mortgage on the property and \$150,000 to a bank for machinery.
- The organized workers, a group of 64 STITTAS members who are now acting independently from that union, have filed a number of labour cases against the owner.<sup>2</sup> There are also two criminal cases filed by the Government (for failure to make full social security and pension contributions and the misuse of such funds).
- After the FLA companies filed their assessment, they were informed by the Government that since Hermosa Manufacturing's assets, including machinery and property, had been pledged to a bank as collateral for loans, the bank had precedence over them. (The Salvadoran

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<sup>2</sup> In total, 63 Labour Tribunal cases have been filed against Hermosa's owner. According to an update issued by adidas, "approximately 30 cases have been ruled in favour of the workers (17 of those are being appealed by the Hermosa owner) but there are no Hermosa assets available to pay the compensation awards." Labour rights NGOs in El Salvador are highly critical of the Labour Tribunals and the potential for legal redress within that system. The US State Department also reports problems of "corruption among labor inspectors and in the labor courts" which impede enforcement of Salvadoran labour laws (<http://www.state.gov/g/drl/rls/hrrpt/2006/78891.htm>), and Human Rights Watch has reported on the failure of the Salvadoran system to effectively protect worker rights (see "Deliberate Indifference: El Salvador's Failure to Protect Worker Rights", December 2003 Vol. 15, No. 5(B)).

Constitution gives precedence to the claims of workers for compensation over those of bank liens regarding the disposition of assets, however, there is no enabling legislation to implement this Constitutional right of workers.)

We also note the following additional facts:

- Because their former employer failed to make payments to the *Fondo Social para la Vivienda* (the Social Housing Fund), a number of workers have been evicted from their formerly subsidized housing.
- Because their former employer failed to make payments to the government *Instituto Salvadoreño del Seguro Social* (ISSS) Social Security plan<sup>3</sup> and the *Administradora de Fondos de Pensiones* (AFP) pension plan<sup>4</sup> despite having deducted these amounts from workers' wages, workers have been denied access to the ISSS health care services as well as future pension benefits.<sup>5</sup>
- Approximately 50 former Hermosa workers were hired at a new factory of which Hermosa owner, Mr. Montalvo, is a part-owner (MB Knitting). To our knowledge, these workers did not make compensation claims against Hermosa within the legal time limit for monies owed to them.
- Between 40 and 80 former Hermosa workers have been hired at a neighboring factory, Chi Fung.<sup>6</sup>
- None of the organized workers have been hired at either MB Knitting or Chi Fung. The 63 organized workers who filed complaints did not receive a *constancia* (record of employment) from the employer, which has contributed to their inability to find alternative employment.
- Investigations by both the FLA and WRC have found evidence of blacklisting at Chi Fung. adidas and other FLA-affiliated companies have since conducted training on human resources policies at Chi Fung and the factory has altered its hiring practices. However, the WRC and the organized former Hermosa workers believe that the changes are not sufficient to prevent blacklisting.
- The expert commissioned by the FLA to investigate the Hermosa situation reported, "The families of the workers experienced a severe economic crisis. At times, they do not have enough money to cover basic necessities: food, children's education, medical expenses, and some of them have lost their homes because they could not pay the corresponding monthly payment."<sup>7</sup>

A third party complaint was filed with the FLA by Christliche Initiative Romero (CIR) on December 8, 2005. The third party complaint alleged violations of freedom of association, failure to pay wages, severance and other legal benefits due to the workers, as well as failure to provide alternative employment. It did not address the question of blacklisting.

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<sup>3</sup> The monthly employee deduction for the *Instituto Salvadoreño del Seguro Social* (ISSS) is 3% of wages including overtime and bonuses, to be complemented with 7.5% from the employer.

<sup>4</sup> The monthly employee deduction for *Administradora de Fondos de Pensiones* (AFP) pension contributions was 6.25% of total wages, to be complemented with an employer contribution of 6.75%.

<sup>5</sup> Pension benefits are calculated on the basis of the number of years worked – that is, for which payments have been received. The GMIES reports that Hermosa did not pay into the AFP between September 2004 and June 2005.

<sup>6</sup> Different parties provided vastly different estimates of the number of ex-Hermosa workers hired at Chi Fung since 2005. Factory management estimated that more than 80 ex-Hermosa workers had been hired at Chi Fung.

<sup>7</sup> Fair Labor Association. Interim Summary Report: Third Party Complaint Regarding Hermosa Manufacturing, El Salvador. 25 August, 2006. p. 4 (available at: [www.fairlabor.org](http://www.fairlabor.org))

## 5. Actions to Gain Compensation from Government/Employer

Interviews with buyers suggest that the FLA and FLA member companies, principally adidas Group, Nike and Russell, put considerable time and staff resources into advocating with various branches of the Salvadoran government, the employer and other Salvadoran institutions in an attempt to gain compensation and employment opportunities for the workers. These efforts included:

- Numerous meetings with the organized workers, the Minister and Vice Minister of Labor, the Ministry of the Economy, the Presidential Commission for Democratic Government, El Salvador's Ambassador to the US, the owner of Hermosa Manufacturing, officials of the US Embassy, the Salvadoran Textile and Apparel Association;
- Follow-up letters to the Ministry of the Economy;
- A series of meetings with senior El Salvadoran government officials, the owner of Hermosa, and 30 former Hermosa workers;
- The engagement of the Independent Monitoring Group of El Salvador (GMIES) to provide technical assistance to adidas in facilitating meetings with the Banco de Cuscatlán, ISSS officials, and other Salvadoran institutions; and
- The intervention of the US Embassy in El Salvador in an attempt to help achieve a resolution to the case.

Despite these numerous meetings and follow-up correspondence, interviews with all parties suggest that few concrete results were achieved. Although the government initially promised to provide workers access to ISSS health care programs, which is the legal right of employees in El Salvador, it failed to carry through on that promise.

According to the organized workers interviewed, the government has reneged on its promise to provide the workers access to the ISSS health system and is currently only offering access to the public health system, which is vastly inferior to the system available to employees and is already available to all Salvadorans. The public system has been plagued by low service capacity, long waits for treatment and medication, and inadequate follow-up.

The buyers and the FLA were equally unsuccessful in convincing the government or the banks to ensure that the workers were given priority over other creditors concerning the dispersal of the assets of the company, as guaranteed in the Salvadoran Constitution.

According to the buyers interviewed, the government also offered to give the workers priority access to employment opportunities in a government-sponsored job fair. However, according to the workers they were only offered the opportunity to compete in the job fair "raffle" on an equal basis with all other job applicants for employment as a security guard or in a bakery that either paid far less than those in their sector, did not match their skills, or were located far from their community.

Interviews in El Salvador with individuals who have examined the Hermosa case confirmed that the government has not kept its promises to the workers. One person who carried out an investigation of the Hermosa situation stated the following:



The government promised health care, and to help find work, but in reality this did not happen. Workers have a right to a [ISSS] certificate .... This is not a privilege. The government said the workers could go to the national health care system. Anybody can go to the national health care system. Anybody can go to a government job fair. There is nothing special in this.

The buyers expressed considerable frustration with the various ministries of the Salvadoran government for their failure to respond to follow-up letters concerning actions the government had promised to undertake.

## **6. Job Opportunities versus Priority Hiring**

According to the buyers interviewed, in addition to their efforts to gain action from the Salvadoran government, some of them also urged their other suppliers in El Salvador to provide employment opportunities to the former Hermosa workers.

However, the buyers told us they were unwilling to pressure those suppliers to give ex-Hermosa workers priority in hiring, as was requested by the organized workers, some Salvadoran civil society organizations, and international campaign groups, because they did not believe they have the right to tell another company whom to hire.

According to the organized former Hermosa workers, while a number of Hermosa workers have been hired in some factories, including at Chi Fung, a nearby factory that produces for some of the same buyers, and at MB Knitting, which is owned by the former owner of Hermosa, not one of the organized workers has been hired at another garment factory in El Salvador. The fact that their former employer was unwilling to provide them a *constancia* has also hindered their chances of being hired and, according to the Worker Rights Consortium (WRC), has acted as an informal blacklist.

The buyers interviewed acknowledged that blacklisting is a common problem in El Salvador and Central America as a whole. They noted that in response to evidence of blacklisting at Chi Fung, the factory made changes to its hiring policy and procedures. As well, in May 2006, an FLA consultant conducted non-discrimination training for 69 Ministry of Labor inspectors and 35 representatives of factories producing for adidas Group, Nike and Russell, including the Chi Fung factory. In February, 2007, the FLA repeated the training with 10 factories supplying FLA and non-FLA brands.

Following the FLA trainings, Chi Fung management reportedly made changes in its hiring policies and practices and no longer requires a *constancia* as part of the hiring process. Also, personal identification documents are reportedly not required until the worker is offered a position, rather than at the beginning of the process.

An FLA audit verified that there was evidence of blacklisting practices at Chi Fung prior to the training, but that the company made changes to its procedures in May 2006 so that prior employment history is not collected during the hiring process. The auditors recommended follow-up audits to review the integrity and effectiveness of the new hiring procedures.

In October, 2006, adidas issued a letter to the former Hermosa workers, not just the 63 organized workers, explaining the new process at Chi Fung and what they could expect if they came for a new interview.<sup>8</sup> The letter offered that workers could contact adidas at a local number if the new hiring procedures were not respected. Adidas reports that they have not received any complaints. A similar letter was sent to workers in May, 2007.

The organized workers we interviewed were aware of the non-discrimination training programs that were conducted with factory management and labour ministry personnel, but they are convinced that management is taking measures to get around the process, and that blacklisting continues to take place. They pointed to the experience of organized workers who applied for work at the Chi Fung factory in August 2006, three months after training had taken place and new procedures had been instituted in the factory.

One of the workers we interviewed told us she applied for a job at the Chi Fung factory in August 2006. She said at the time she applied, a bulletin board outside the factory advertised positions for *raneras*. However, during her interview “the boss of the supervisor” told her that they only needed *planeras*.<sup>9</sup> The worker told her she did not have much experience on *la plana*, although she is an experienced operator. At the end of her interview and a factory tour, she said she was tested exclusively on *la plana*, and given a particularly difficult operation to perform. We were told a second worker who applied at the same time and another one as recently as April, 2007 had the same experience. A third worker who applied in August 2006 said she was reportedly told that her *Documento Unico de Identidad* (national identity) card was outdated and that she would have to get a new one before she applied again. Although under the new system the factory is not supposed to ask for identity cards until after an applicant has been offered employment at Chi Fung, we were told that all three of these workers were asked for their documents prior to testing.

Chi Fung management told us that the workers who applied didn't have the skills to produce the kind of goods Chi Fung manufactures. “They don't know how to do it. Hermosa used to make simple garments . . . Hermosa used to do t-shirts . . . We do jeans. They don't know how to sew jeans.”

“Don't ask me to hire people who can't do the work,” we were told. “They don't know how to sew. Why insist that I hire these people? If they're willing to work, sure, but they don't want to work. They're only trying to make a scandal. I don't like them for that.”

She confirmed, however, that Chi Fung had hired a number of ex-Hermosa workers after the closure of the Hermosa factory. “When Hermosa closed, we hired more than 80 persons. Today I don't know how many work here. Once they are here, they are Chi Fung workers, we don't keep track.”

As a result of the accounts of organized ex-Hermosa workers who applied at Chi Fung, the organized workers firmly believe that Chi Fung is continuing to use various tactics to bar them from gaining employment in the factory, and that the blacklist is still being applied at the factory.

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<sup>8</sup> adidas requested that GMIES and the WRC distribute the letter to the ex-Hermosa workers.

<sup>9</sup> *Raneras* and *planeras* refer to operators of two different machines (*maquina rana* and *maquina plana*, respectively). The *maquina plana* sews flat seams, including operations such as top-stitching, sewing collars, pockets and waistbands. The *maquina rana* is a serger which cuts and sews and fabric using multiple threads. It is used to sew side seams, hems, and t-shirt necks, among other operations.

The workers believe that they will only receive employment opportunities at Chi Fung if and when the buyers insist that the company hire them on a priority basis. That proposal was echoed by almost every NGO and/or trade union representative we interviewed, but rejected by the buyers.

One NGO told us, "Chi Fung should give priority to ex-Hermosa workers. If they're qualified, they get priority over others in hiring . . . . If even two workers were hired at Chi Fung, that would send a signal [to the other ex-Hermosa workers] that it's worth their while to go apply again."

"We have to look at results," said another NGO. "The results are that none of the organized workers found work at Chi Fung." No Salvadoran NGO representative nor worker with whom we talked believed the problems of blacklisting had been eliminated as a result of the non-discrimination training and changes in the Chi Fung's hiring procedures.

## **7. FLA Emergency Fund**

On December 22, 2006, the FLA announced the creation of an Emergency Fund "to provide immediate and direct assistance to the [former Hermosa] workers while efforts continue to hold the government of El Salvador and the factory owner responsible for carrying out their legal obligations to the workers." The media release also refers to continuing efforts to find jobs for the workers and to eliminate blacklists.

According to the media release, the Fund was to be administered by the Salvadoran NGO FESPAD, and an "initial distribution of \$36,000" was to be made before December 30, the implication being that additional funds would be raised and distributed at a later date.

The idea of the FLA's Emergency Fund came out of discussions between adidas, CIR, the Clean Clothes Campaign, and the FLA. "The original idea was to do something sustainable, such as job training or micro-credit," according to one FLA staff person. However, because of the desperate situation the workers were facing as Christmas was approaching, they decided to provide direct financial support.

The proposal provoked a great deal of discussion and debate within the FLA Board concerning whether there was a responsibility to provide financial support and whether this would be viewed as a substitute for the money that was due to the workers. According to an FLA staff person, "The Board made a pragmatic decision – the unresolved issues continue, but there is a human tragedy here, so let's give these folks some financial support. We'll have a fund, we'll evaluate it, and that may give us some ideas for the future."

On December 22, FESPAD published a notice in two Salvadoran newspapers inviting all former Hermosa workers who had lost their jobs as a result of the factory closure and were not currently employed to visit their office on December 27 or 28 to discuss matters of their interest.

On December 27 and 28, a total of 57 workers visited the office and received equal amounts of monies from the fund. Of those 57 workers, 49 were union members; 4 non-union members, but sympathetic

to the union; and 4 non-union. Because some of those workers had secured low-paid employment, but continued to carry a heavy debt load from months of unemployment, at FESPAD's suggestion, FLA agreed to include those workers among recipients of the fund although they were employed and therefore did not meet the criteria.

Of the \$36,000 in the Fund, \$3,000 was held in reserve for additional claims. When no additional workers applied, the organized workers proposed that the remaining funds be allocated to them to help cover legal costs in their court cases and to provide counseling for people suffering depression as a result of the pressures they were under. The FLA decided instead to divide the monies equally among the 57 workers. On February 2, 2007, FESPAD distributed the supplementary amount among the eligible workers.

In total, each of the 57 former Hermosa workers received about \$600, the equivalent of about 2 ½ - 3 months wages.

If there is one area of agreement among all parties interviewed for this study it is that the distribution of the funds by FESPAD was carried out in a fair, impartial and efficient manner. "They were a very professional operation," said one FLA staff person. "They had a team of lawyers, solid criteria, a notary public on site, and they checked people against a list of workers."

However, differences of opinion remain concerning which former Hermosa workers should have had access to the funds distributed. While some of the buyers interviewed believe the funds should have been made available to all former Hermosa workers who lost their jobs as a result of the factory closure, irrespective of their current job status or economic need, the organized workers and the labour and nongovernmental organizations interviewed believe that given the limited amount of funds that were made available and the economic hardship suffered by the organized workers, all monies should have gone only to the organized workers.

A second area of general agreement is that the \$36,000 provided was grossly inadequate to address the desperate situation faced by many of the former Hermosa workers.

The organized workers interviewed said they accepted the monies made available through the FLA Emergency Fund because of hunger, not because they thought it was fair or sufficient. For some women, they said, the fund meant they could be diagnosed with an illness, but then couldn't afford the necessary medical treatment.

According to a number of sources, the original goal was to raise a minimum of \$100,000. However, the response from the brands was not as strong as expected. "The amount shrank before our eyes, I don't understand the reasons," said one FLA staff person. "There was a lack of confidence; everybody thought it would explode in our faces."

Because contributions to the Fund were anonymous, it was impossible for MSN to track which companies contributed and how much. Some contributions came from companies that were not affiliated with the FLA. One university contributed to the Fund as well. While some of the brands interviewed felt that having contributions anonymous made it easier for companies to participate,

anonymity also made it difficult for those brands to follow up with their peers and encourage donations from other companies.

## **8. Views of the Buyers on the Emergency Fund**

Not surprisingly, the greatest area of disagreement among those interviewed was the question of whether the buyers have a moral, if not a legal, obligation to fully compensate the former Hermosa workers for the monies owed to them by their employer.

One possible reason for the small amount of contributions to the Emergency Fund was the fear of setting a precedent. “Even as philanthropy, people were concerned it would set a precedent, that it would always be expected,” said an FLA source.

This was echoed by another FLA staff member: “Even when the Terms of Reference were clear on the FLA’s side, the Fund was misconstrued [by some campaign groups] to be part of a severance package owed to the workers, which made it problematic to get brands to participate.”

That concern was shared by a number of the buyers interviewed. At least one FLA Participating Company interviewed, which had not sourced from the factory, said they did not donate to the Fund because they didn’t want to set a precedent. “We’d be willing to offer donations of clothes or maybe even give cash to some organization doing work that would benefit the workers.”

An FLA member company that did contribute to the Fund expressed its concern about the linkage to compensation. “Groups said the amounts were not high enough because of the amounts that were due to the unionized workers. I didn’t see why we were using that as a negotiating number. This Fund is only to relieve emergency needs... We don’t have an obligation to pay the workers, but we do have an obligation to work with the stakeholders to ensure that the workers are on top of the list for compensation [from the employer’s assets in bankruptcy cases].”

Another FLA member company stated, “I was against the establishment of the Fund, but this was a very special situation. We felt we had to follow through, but it’s not a precedent going forward.”

The company representative also noted, “I had serious reservations about the FLA’s capacity to administer the Fund – who’s going to investigate, who’s going to establish the Fund, who’s going to solicit the money? The FLA is not equipped to do this; it’s not the purpose of the FLA.”

She went on to propose that if a fund is set up in the future, all aspects of the fund should be managed by a separate organization that is credible and impartial. “The FLA should not manage a fund. If all other avenues are exhausted, then we may recommend the use of a fund, but it should be managed and delivered by an NGO, either local or international, and one that is objective.”

Another FLA member company that sourced from the factory and contributed to the Fund stated: “We looked for a way that we could have some positive influence, but we can’t see stepping in to pay compensation. It would be detrimental to our interests around the world... We can’t engage in that

precedent. We've given it a lot of thought, but it doesn't fit with how we prioritize where to put our resources."

The company lamented the fact that because of the small amount of funds contributed and the few companies involved, "we were not able to put funds to more sustainable uses," such as micro-credit or retraining. "There was a lack of enthusiasm precisely because it was seen as compensation to the workers."

The company also criticized the FLA for a lack of "precision in its communications" around the Fund. "Narrowing down how it was going to work was like pulling teeth with them. We kept asking, what is the process? They were making it up as they went along, which made it hard to sell internally when I didn't have the full details."

Another company that had sourced from the factory said they made a small contribution, "commensurate with the size of the orders." "I thought we had a responsibility in this case because our auditing was rubbish," the company representative said. However they also saw the Fund as a problem: "You could put this factory anywhere in the world. We can't respond like this. It's unmanageable, it's unfair, and it's not proving very effective. We really haven't made a dent in the situation... I think we'd be more careful about doing this again. It's letting the people who are responsible, the owners and the government, off the hook. We couldn't do this in any more countries."

Another FLA-related company that sourced from the factory said his company struggled with the question of its obligation to the factory. However, it had a more positive evaluation of the Fund: "As the emergency fund was unprecedented, the FLA should be commended for all of their efforts in achieving this. Although there have been many negative reactions to the fund, we believe it did achieve its goal of providing temporary emergency relief to the workers."

He went on to express his support for a more permanent fund: "It would be prudent for the FLA to explore the establishment of a humanitarian fund to which all Participating Companies could contribute. With appropriate guidelines in place, the financial response to these situations could be more expedient." This company representative was the only one to express support for a more permanent fund.

A university representative was also supportive of the Fund, and believes universities that are part of the FLA should also contribute. "I understand the risk that we might create expectations, but I was prepared to take that risk. This is the first time, so we can describe it as a pilot."

## **9. Other Stakeholders' Views on the Fund**

While there was general agreement among all parties interviewed that the monies provided to the workers through FLA Emergency Fund were inadequate to address their desperate situation, NGO and labour stakeholders external to the FLA had dramatically different interpretations of the Fund and buyer obligations to the workers.

As noted above, the organized workers who were interviewed believe the brands should compensate them for the full amount that is owed by their supplier. They also stated that they are very concerned about whether there would be a second stage of the Fund, since that is what was suggested in the FLA announcement of the Fund.

Other organizations consulted in El Salvador suggested that there were some positive impacts of the Fund. One NGO noted that the impact of the Fund in terms of solidarity has been good. "Nobody [in El Salvador] was expecting the Fund, and it was unusual to have something like this happen." They go on to say, however, that the impact of the Fund economically has been insufficient: "It does not cover what the women are owed or compensate them for what they have experienced – women have lost babies, homes, are not able to buy proper food."

They propose, "There should be an ongoing fund for cases of bankruptcy and closures and to ensure companies comply with their responsibilities for social security and pensions."

Representatives of another Salvadoran NGO agreed, stating: "Workers had gone 18 months without any salary. They received approximately \$590 at Christmas, which represented about four months of their salary. We have to take it as something positive, but it was not sufficient. Workers used the money to pay their debts; it was spent in 48 hours or less. Some workers used the money to pay for an examination to determine whether they had cancer but then were left without monies to begin treatment."

International trade union and labour rights organizations that were involved in the case were unanimous in stating that the buyers have a responsibility to compensate the workers for what they are owed.

"Essentially it's an employer's responsibility to compensate workers when their factory closes," said one international NGO. "If the employer fails to do so, the state should ensure that compensation is provided. If the state fails in a context in which there is an extreme lack of global responsibility, the brands have to ensure that compensation is paid. When they had the leverage, they didn't deal with the problem. So, in a sense, they have to pay for their own mistakes."

At minimum, the NGO representative said, the brands should pay another \$100,000 to the organized workers.

Others pointed to the brands' failure to address problems at the Hermosa facility early on, noting that CIR had been bringing the problems at Hermosa to buyers' attention since 2000. For that reason, they said, the brands have a responsibility to compensate the workers. They also pointed to the fact that FLA audits failed to uncover the problems at Hermosa.

Others suggested that the long time frame for workers to pursue legal restitution created a need for brand intervention: "My suggestion was that the buyers create a fund for compensation, the workers get paid, and then the buyers pursue the compensation through the legal channels."

One of the trade union organizations interviewed agreed with the suggestion. "In cases where the factory closes and the workers are left in abysmal situations, the buyers have to accept responsibility. . .

The workers are the last ones that should suffer. In such cases, it should be up to the brands to pay the compensation, and it should be up to the brands to recuperate their money owing from the factory owner, the bank, or the government. It could take forever, and the workers can't wait. The brands should do it."

The trade union organizations consulted for this study were harsher in their criticisms of the Fund than were the NGOs: "The Fund is insulting, it can't be held up as a success in any way, shape or form. It was \$36,000 out of over \$800,000 owed. That is an insult. There is no way it can be hailed as a success. It's not much progress at all."

One charged that the brands "seem to be out to prove that this is not a precedent by making it not worthwhile. You fight for a year and a half, and you get a pittance. It's truly disgraceful."

In November 2006 the International Textile, Garment and Leather Workers Federation (ITGLWF) suggested a meeting be held in El Salvador in which the FLA and the brands could sit down with the former workers and other stakeholders in order to jointly work out a solution in an open and transparent manner. The ITGLWF noted that, surprisingly, the only company that responded positively to the proposal for a meeting was Wal-Mart. Others, we were told, felt that progress was being made in consultations with the various stakeholders and therefore they did not feel that a meeting was necessary. The ITGLWF, we were told, made renewed approaches to the brands after the Fund was established and has again proposed a meeting to examine how the different players can contribute to ensuring that the workers are able to secure alternative employment and receive the full compensation that is owed to them.

Some NGOs and trade union organizations interviewed also challenged the idea that providing humanitarian assistance in the Hermosa case might set a precedent for brands, pointing to the fact that there have been other humanitarian funds created to address similar situations and that those funds generally delivered more financial support to workers than has the FLA Emergency Fund to date. Some examples of other humanitarian funds are provided in Appendix "A" to this report.

## **10. Current Situation of the Organized Workers**

On February 24, MSN met with a group of 20 organized former Hermosa workers. On Feb 28, MSN carried out in-depth interviews with 5 of these organized former workers, who are members of the Executive Committee of Ex-Hermosa Workers. Lastly, MSN did follow-up interviews with four of the organized workers on May 11.

According to those interviewed, the majority of the organized workers are single mothers. In 2005, a majority of those women reportedly had to take their children out of school because they could no longer afford to pay school fees. At least five of the women have lost their formerly subsidized homes because their former employer didn't remit their contributions to the Social Housing Fund despite deducting payments from their wages. Some are suffering serious illnesses, including cancer, and no longer have access to ISSS health care services despite promises to the contrary by the Salvadoran



government. The health of a number of workers with serious conditions is rapidly declining as they are forced to wait months for treatment in the national health care system only to face postponements due to lack of equipment, medication or services.

Given the fact that other options pursued by the buyers have failed to achieve payment of the compensation or alternative employment, the organized workers feel that the brands should assume that responsibility and fully compensate them for the monies they are owed, and at minimum provide work for the organized workers as a group, preferably at Chi Fung due to its geographic proximity. However, they are not demanding that all the workers be hired at once. Workers told us, "We would like to see an agreement that one supplier hires all of us, but it doesn't need to be all at once. It could be three of us one week, and two of us another week...."

The organized workers also feel that because other former Hermosa workers failed to make claims to the Ministry of Labour for monies owing, and because they were not blacklisted and could therefore gain alternative employment in the garment industry, any additional monies contributed to the FLA fund should go to the organized workers.

## **11. Conclusions and Recommendations**

Industry restructuring in the wake of the quota phase-out has made factory closures an all too common occurrence in many apparel-producing countries. The downward pressure on wages and working conditions from the threat of relocation of orders and investment is not only reducing workers' standard of living, but also discouraging workers from exercising their rights and governments from enforcing their laws. The complete elimination of critical sources of employment in precarious local economies is devastating for workers and communities. The failure of employers to even meet legally-required severance and social security benefits to laid off workers is literally criminal.

The fact that factory closures – and irresponsible practices related to closures – are becoming all the more widespread, has raised the stakes in the Hermosa case. All parties involved are well aware that the actions taken and commitments made in this particular instance are potentially precedent-setting and can therefore establish expectations and obligations for future factory closures and/or factory exits in other parts of companies' global supply chains. At the same time, buyers (brands, retailers and manufacturers that subcontract production) cannot ignore the negative impacts of global restructuring nor escape their shared responsibility for the impacts of corporate decisions in this post-quota transition period.

Given these challenges, the FLA took a risk in deciding to create the Hermosa Emergency Fund. From the interviews we conducted, it appears that the risk was worth taking:

- The severe difficulties faced by the workers and the failure of both the factory owner and the Salvadoran government to meet their legal responsibilities to those workers are well established and beyond dispute.

- While there is general agreement on all sides that the amount of the initial Emergency Fund distribution was grossly inadequate, there is no doubt that the initial distribution made a real difference for these workers at a critical time.
- There was also general agreement that the initial distribution was well-managed by FESPAD.
- Although some of the brands interviewed felt that it was difficult to get the FLA to nail down the operational details of the Emergency Fund, making it unclear exactly what donors were committing to, on the whole there was little criticism of the operational details on the FLA's side.
- Most criticism was focused on the conceptualization of the Fund and the amount of the initial distribution – issues the FLA already knew would be contentious going into the Emergency Fund project – rather than the execution of the project.

The FLA, in its initial announcement of the Emergency Fund, made clear that the Fund is intended only to provide immediate assistance to the workers while efforts to remedy the overall situation continue. As well, the \$36,000 distributed was described as an initial distribution to be followed by a second distribution.

With that statement in mind, we submit the following recommendations for further action by the FLA and its members in the Hermosa case:

### **11.1 A second round of Emergency Fund distributions**

The FLA's December 22 announcement of the Fund gave the affected workers and other stakeholders the expectation that the "initial distribution of \$36,000" would be followed by "[a] second distribution... if additional funds become available." The fact that April 1, 2007 was set as the deadline for receiving additional contributions does not lessen that expectation, or the critical situation faced by the workers.

Given the near-unanimous agreement that the initial distribution was insufficient, brands should be encouraged to contribute to a second and final round of Emergency Fund distributions.

The original financial goal of the Fund was at least \$100,000, and we were told that initial pledges were made for \$50,000, which, for whatever reason, failed to materialize. Now that the fund has made an initial, successful distribution, the FLA should actively encourage all brands whose products were made at Hermosa, both FLA and non-FLA companies, to make a second and final contribution, with the expressed objective of raising an additional \$100,000, to be distributed with the next three months.

Given that the Fund has been clearly designed to meet the emergency needs of affected workers, we would also recommend that any additional monies collected go to those workers who have been most negatively affected by the factory closure – the organized workers who

have been unable to gain alternative employment allegedly because of blacklisting and the failure of the Salvadoran government to make good on its commitment to provide preferential employment opportunities.

## **11.2 Requiring/encouraging suppliers to provide preferential hiring to the organized ex-Hermosa workers**

According to the workers, the brands involved, the FLA and the WRC, there has been blacklisting of ex-Hermosa workers and discrimination in hiring based on union membership at Chi Fung. The FLA and adidas have conducted training and assisted the factory in changing its hiring practices in an attempt to eliminate this practice in the future. However not a single one of the organized ex-Hermosa workers is currently working at Chi Fung.

Where there is evidence that any former Hermosa worker was subjected to blacklisting at the factory – either refused employment without adequate justification or hired then quickly dismissed – brands should insist, at minimum, that corrective action be taken and that those workers<sup>10</sup> be given immediate priority hiring at Chi Fung.

In addition, the FLA should verify whether the training and changes in hiring practices at Chi Fung have been effective in eliminating discrimination in hiring.

Although the stated policy at Chi Fung is to require DUI cards only after an employee has been tested, there is testimony that at least three of the organized workers were asked for identification documents earlier in the hiring process. If management harbours any reticence about hiring the organized ex-Hermosa workers, early identification would provide management the opportunity to discriminate in hiring.

We recommend that the FLA, in consultation with the organized ex-Hermosa workers, identify an acceptable independent party to monitor the hiring process at Chi Fung, in order to ensure that the new hiring practices are followed and that anti-union discrimination is not present. If an acceptable third party is present to monitor hiring, we recommend that the organized ex-Hermosa workers be encouraged to apply for positions open at Chi Fung.

Because workers believe that qualifying examinations are now being unfairly used as another means of blacklisting, whoever monitors the hiring process must ensure that any skills testing is necessary and relevant to the specific position(s) for which the worker is applying and that on-the-job training is available where testing reveals a need for improvement in a particular area.

Lastly, the organized ex-Hermosa workers believe that they were subjected to blacklisting at Chi Fung and are therefore discouraged from applying for work at the factory. This fear is aggravated by the fact that none of the organized ex-Hermosa workers who have applied at the factory – before or after the hiring process was revised – have been hired. In order to dispel

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<sup>10</sup> The Worker Rights Consortium has identified “no more than 16” organized ex-Hermosa workers who had applied for work at Chi Fung by April, 2006. Several more have made attempts since that time.

this fear we recommend that all the organized workers be treated as a class and be offered preference in future hirings at Chi Fung irrespective of whether they have applied for employment previously at the factory.

We recommend further that brands that sourced from Hermosa also strongly encourage their other suppliers in El Salvador to offer priority hiring to any of the organized ex-Hermosa workers, as well as other former Hermosa workers who are currently unemployed, who are qualified to do the work in question.

Buyers have raised concerns that this may entail discrimination against other new job applicants who may be equally deserving of employment. However, given the prevalence and persistence of blacklisting in El Salvador and the impact of blacklisting on workers in this particular case, we would argue that a clear message must be sent to all Salvadoran suppliers producing for FLA member companies and other buyers that sourced from the Hermosa factory that blacklisting and other forms of anti-union discrimination will not be permitted to stand.

### **11.3 Further joint pressure on the Government of El Salvador to deliver on its promise of ISSS health care**

Nike and adidas insist that the Government of El Salvador promised in early April 2006, that it would offer access to ISSS health care for a period of one year to the unemployed ex-Hermosa workers. For whatever reason, that promise has never been fulfilled. Nike and adidas have both made efforts to follow up on this and other matters with the Government of El Salvador, but report little progress since that time.

Given that access to quality health care was repeatedly cited by workers and NGOs on the ground as a critical issue, ensuring that the unemployed workers have access to the full ISSS employee health plan is a logical step in remediation of this injustice.

We are aware that the Government of El Salvador has been unresponsive to communications from Nike and adidas to date. We recommend, therefore, that FLA encourage all FLA Participating Companies and licensees who source from El Salvador, as well as other companies that sourced from Hermosa, to join with the FLA in signing an Open Letter to the Government of El Salvador reminding the government of the volume of work the buyers are sourcing from the country, stating the need for enforcement of local labour laws and reliable government action to protect worker rights, including ensuring regular payments to Social Security (AFP and ISSS), and strongly urging the Government of El Salvador to fulfill its promise to provide ISSS health care to the unemployed ex-Hermosa workers for a period of one year. Further, we recommend that this letter be sent to the media in El Salvador and the US upon its release.

### **11.4 Meeting of stakeholders in El Salvador**

In November 2006, the International Textile, Garment and Leather Workers Federation (ITGLWF) proposed a meeting in El Salvador of all stakeholders in the Hermosa case to seek consensus on next steps and take coordinated action to resolve the outstanding issues. Now

that the first distribution has been completed, we recommend that the FLA, in collaboration with the ITGLWF, convene a meeting in El Salvador involving all relevant stakeholders in order to discuss, at minimum, the recommendations contained in this report and other possible means of addressing the outstanding issues, including how to ensure that former Hemosá workers receive outstanding compensation owed to them and that those workers who remain unemployed receive employment opportunities that make the best use of their skills and experience and provide, at minimum, an income comparable to that received in their previous employment. We also recommend that the parties make use of their presence in the country at the time of the meeting to publicly advocate for the Government of El Salvador to assist the ex-Hermosa workers and put in place further legal safeguards to prevent future “Hermosas” from happening.

## **12. Lessons to Be Learned from the Hermosa Case and further recommendations**

All participants in the study expressed a desire to avoid “another Hermosa,” but many voiced concerns that, without significant changes in the industry, another Hermosa was all but inevitable. The following recommendations do not constitute a complete list of actions that buyers, manufacturers, governments and other stakeholders can and should take to remediate the disastrous effects of factory closures. Rather, they are a set of modest recommendations that are intended to avoid some of the specific injustices that accompanied the Hermosa closure.

### **12.1 Social Security and Other Payments**

A common theme in most of the interviews, whether from company compliance staff, NGOs or labour organizations, was the failure of internal and external monitoring and verification programs, as they are currently constituted, to detect whether suppliers are up-to-date in their legally required contributions to government social security and pension programs. Buyers need to ensure that legally-mandated payments to social security, pension or other legally required contributions are not only recorded, but also that the deposits are completed.

In order to identify potential violations in this area, interviewees made a number of recommendations about monitoring, with which we concur:

- Buyers should require certification that full and up-to-date deposits into social security and pension accounts have been made;<sup>11</sup>
- Buyers should insist that suppliers not borrow against social security funds, even if such practice is legally allowed in the producing country;
- Buyers should monitor suppliers and potential suppliers for credit-worthiness before placing orders;

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<sup>11</sup> One company representative advised that the Salvadoran government now requires companies producing for export to obtain letters certifying they have paid their social security obligations. However as this only applies to factories exporting goods, subcontractors that do not directly export their products are not legally required to produce similar documentation. Nonetheless, buyers and contractors can demand certification as a condition of doing business with suppliers.

- Buyers should run checks to ensure the owner has not previously shut down facilities without meeting legal obligations or shut down a company and re-incorporated in order to prevent worker organization or collective bargaining within their facility;
- Buyers should better track where their goods are being manufactured and ensure that unauthorized subcontracting is not taking place;
- Buyers should provide an anonymous grievance procedure and/or encourage the negotiation of a grievance procedure between the employer and a trade union organization representing workers in the factory (where one exists) so that workers have an avenue for registering complaints and achieving resolutions to those complaints;
- Monitoring should focus on high risk issues in the region and include more in-depth investigation on those issues, as opposed to a check-list approach to audits;
- Monitoring should focus on workers and worker interviews; and
- Buyers should engage with stakeholders within the region/country on a regular long-term basis in order to better identify and alleviate common worker rights abuses.

Most of these recommendations should be considered due diligence by buyers.

While the exact method of obtaining certification of social security deposits will vary from country to country, ensuring a supplier can meet all their legal obligations in the event of a closure is a key step in avoiding another Hermosa.

It is also worth noting that a number of people interviewed pointed out that factory audits are not the only, nor necessarily the most effective, method of ensuring that required contributions to government social security, pension and housing programs are being made. Government itself can and should be a source of such information. If the status of employer contributions to such programs is not available upon request from the appropriate government department, buyers, trade unions and other organizations should be lobbying for greater access to that information.

## **12.2 Severance Payments**

A second area of general agreement is that companies must take proactive and preventive measures to ensure that workers receive their legally required severance pay at the time of factory closures or worker retrenchment, rather than being forced to react after the fact.

Severance payments, while legally required in El Salvador, are notoriously unfulfilled, in part because there is no requirement to reserve severance funds prior to closure. As a result, the requirement to produce funds to pay severance comes at a time when a shuttered factory is in all likelihood facing other financial difficulties associated with closure and the owner is responding to other demands for payment from more powerful institutions.

A number of people interviewed made suggestions to address this serious problem.

We recommend that buyers and the FLA explore the following options to ensure that their suppliers are prepared to make legally-required severance payments in the event of a closure:

- The creation of escrow account to protect severance funds for the employees, either administered by suppliers as a group, industry associations, national governments, or as a code requirement for individual suppliers. There are various approaches which should be explored. While a government-run program would be the most consistent and farthest reaching,<sup>12</sup> there are precedents for private programs as well. The simplest and most immediate solution to this problem would be for buyers to require the employer to regularly place employee and employer contributions into an escrow account managed by a financial institution or individual accounts on behalf of each worker, and to monitor to ensure that payments are made. Such an approach would be more effective with suppliers with which the buyer has a long-term business relationship.

Another approach would be for the FLA and/or buyers as a group to lobby for governments to require manufacturers to place such contributions in escrow accounts. In Colombia, for example, severance pay must be deposited into individual savings accounts for each worker, which can therefore be accessed even in the event of company bankruptcy or flight. Chile also has an individual accounts system, but in addition the employer and the government contribute to a solidarity fund that can be accessed under certain conditions if the individual fund is depleted. Brazil and Peru also have some variation of the mandatory severance payment options discussed here.

- Buyers should consider a contractual hold-back of a percentage of order payments to suppliers until they receive certification that all contract conditions are met, including proof that all applicable payments to workers and/or contributions to government social security and other programs have been made. The practice of applying a percentage hold-back until the buyer receives proof there are no liens against the contractor for things like worker compensation claims is a common practice in the construction industry, for example. Buyers would need to ensure that hold-backs are not applied against debts to other creditors until the supplier's legal obligations to workers are satisfied. It might be possible, for instance, to contractually establish a lien against the holdback on behalf of the workers for any unpaid wages, severance or other debts up to the financial and time limit of the holdback.
- Allowing suppliers to make severance payments annually to workers. This practice, already being done at a number of factories in El Salvador, involves formally laying off workers at the end of the year, paying severance, and re-hiring them at the beginning of each new year. This is a common practice in El Salvador and other Central American countries, and is often used to deny workers their seniority rights. If this method is followed it is therefore critical that the supplier respect seniority rights rather than "re-hired" workers being considered "new" employees. This is the least favoured option, in MSN's view, since it has the effect of depriving workers of their severance pay at the moment they need it the most, when their workplace closes and they need income to cushion their transition to alternative employment. In effect, such arrangements defeat the purpose of severance regulations, transforming severance pay into an annual holiday bonus. However, it is worth noting that a number of Salvadoran NGOs view this as a realistic option.

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<sup>12</sup> There may be concerns about corruption in some jurisdictions, however, which could impact the credibility of a government-run program.

### **12.3 Facilitating alternative employment**

In the Hermosa case, a government-sponsored Job Fair was clearly a poor solution to the need for alternative employment following a factory closure. According to the ex-Hermosa workers, they were not given any priority in hiring, the work available did not relate to their skills and experience, and the pay was below the average in the apparel sector.

Alternative employment should, wherever possible, make full use of the workers' skills and experience, and provide comparable remuneration. Therefore, the effort to find alternative employment for retrenched workers should focus on, in order of priority:

1. finding comparable jobs in the apparel sector, whenever possible in factories owned by the same employer and/or used by the same buyer(s);
2. training for jobs with comparable income in other sectors; and if neither is available
3. facilitating other income generating projects in workers' communities.

There is clearly an issue of whether apparel industry jobs will continue to be available in local areas and even countries which are particularly hard-hit by the current restructuring. For that reason, brands must be particularly sensitive to the impacts their sourcing decisions will have on local employment opportunities. As stated in the MFA Forum's Collaborative Framework,<sup>13</sup> buyers should "contain consolidation in-country" where feasible. And, given the predominance of women workers within this industry, it is essential to ensure that comparable employment for women is available in other garment factories or other sectors when considering a factory exit or significant reduction in orders that might lead to lay-offs.

Where buyer sourcing decisions lead to retrenchment, those buyers must play an active role in assisting workers to obtain alternative employment. Buyers should work with suppliers, governments, trade unions, NGOs and other buyers to:

- encourage their remaining suppliers in the area to hire laid-off workers on a preferential basis;
- provide assistance in locating alternative employment and referrals;
- provide support for re-training for alternative employment; and
- provide start-up loans or funding for small businesses.

Where there is evidence of blacklisting, as discussed above, priority hiring for blacklisted workers should be required as part of a corrective action plan.

### **12.4 Advocacy**

In countries where buyers source a considerable amount of products, buyers should advocate for better government regulations and enforcement of existing regulations regarding contributions to social

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<sup>13</sup> MFA Forum, "A Collaborative Framework for Guiding Post-MFA Actions," March 2005. The MFA Forum brings together retailers and brands, trade unions, NGOs, and national and multilateral public institutions to identify and promote collaborative strategies to support vulnerable national garment industries and greater respect for workers' rights in the period following the elimination of import quotas for the apparel and textile sectors on January 1, 2005. The Collaborative Framework sets out the roles and responsibilities of companies, governments, international institutions and trade unions and NGOs during the post-quota period.



security, pension, housing and other government programs, as well as severance and worker entitlements.

One particular policy which should be a focus of lobby efforts by the FLA, its members, trade unions, NGOs and other stakeholders is legal implementation of the principles set out in ILO Convention 173: Protection of Workers' Claims (Employer's Insolvency).

The main thrust of Convention 173 is that "In the event of an employer's insolvency, workers' claims arising out of their employment shall be protected by a privilege so that they are paid out of the assets of the insolvent employer before non-privileged creditors can be paid their share."

Workers' claims include, at minimum, unpaid wages, vacation pay and severance. In particular, Convention 173 stipulates that workers' claims should take precedence over any claims by the state.

While in the case of El Salvador, the Constitution puts a precedence on workers' claims, there is no legal implementation mechanism to ensure that this right is respected. This also needs to be remedied.

## **12.5 Humanitarian or Compensation Funds**

There has been some question of whether the FLA or another organization should establish a permanent fund to provide emergency assistance or compensation to workers in the event of suppliers failing to meet their legal obligations to workers.

As a precedent, the Hermosa Emergency Fund is too localized and specific to provide guidance on that issue. While its administration was considered a success, for instance, that was in large part credited to the FLA's careful choice of a strong local partner, which becomes considerably harder to do with a more generalized fund intended to cover vastly different regions. Nor is it safe to assume, given the paltry amount collected for a very specific fund of special interest to a number of companies, that buyers would be willing to contribute larger amounts to a more general fund that may or may not relate to closures to which they have been directly connected.

If a more general fund was to be successful, it would require buy-in and management from a multi-stakeholder group that included companies, NGOs and trade unions at minimum. Based on the reaction to the Emergency Fund, it is unclear that trade unions would support or accept the idea of a general, ongoing humanitarian fund. The trade union organizations we spoke with were very clear in their belief that buyers have an obligation to take responsibility for compensation where their suppliers fail to meet their legal obligations.

We do not, therefore, recommend that the FLA establish a permanent humanitarian fund at this time.

This is not to suggest that the FLA or buyers involved in this case should refrain from setting up similar funds on an ad hoc basis in response to emergency situations. In the current period of post-MFA restructuring, we can anticipate that there will be numerous cases in which suppliers close facilities without providing legal compensation and governments fail to enforce their laws. In some cases, unanticipated factory exits by brands will have a direct impact on the ability of the suppliers to maintain

production and meet their legal obligations to redundant workers. Although preventive measures described above are preferable to emergency responses after the fact, there will no doubt be other Hermosas.

In Appendix "A", we set out some examples of other humanitarian funds that have been set up to deal with factory closures in which factory owners failed to meet their legal responsibilities.

One important lesson of the Hermosa case is that buyers' fear of setting precedents concerning liability should not become a reason or excuse for failing to provide financial assistance to workers when monitoring systems fail to detect problems, when employers fail to pay compensation, and when governments fail to enforce their laws. Given the number of precedents that have already been set, such ad hoc humanitarian funds will no doubt continue to be established as the measures of last resort when other mechanisms fail.

## **12.6 Brand Responsibility**

This study shows that there are dramatic differences of opinion between brand buyers and workers, trade union organizations and labour rights NGOs about whether buyers can or should be held accountable when an owner of one of their supply factories fails to make contributions to government social security and other programs or, in the event of a factory closure, fails to provide legal severance pay and other statutory entitlements.

Buyers interviewed were unanimous in their opinion that while they were willing to accept a responsibility to lobby governments and pressure suppliers to ensure that legally-required wages, severance and other payments are made to workers, and to engage with local stakeholders in efforts to secure such payments, they do not accept responsibility to pay those amounts themselves.

The organized ex-Hermosa workers, the trade unions, and international NGOs were just as unanimous in their opinion that brands do have a responsibility to compensate workers when employers and governments have failed to meet their obligations to those workers.

In defending their position, the buyers rely upon a legalistic interpretation of the different obligations of buyers and suppliers, arguing that the workers producing their goods are not employed by the buyer, but by the manufacturer, and that all liability for wages, social security, severance and other employer obligations rests solely with the manufacturer. Legally, at least in jurisdictions where there is no guarantor provision, this is correct (see Appendix "B" for a discussion of guarantor provisions).

Not surprisingly, companies are concerned that acknowledging shared responsibility for such worker rights violations in a particular case would be used to establish a precedent that would strengthen the case for legal liability in the future.

Buyers also argue that assuming responsibility when suppliers fail to meet their legal obligations to workers would have the perverse effect of encouraging suppliers to default on such payments.

In contrast, trade union organizations and NGOs argue that such violations are at least in part the result of buyers' failure to effectively monitor their suppliers' practices, and that an acceptance of shared responsibility or liability will encourage buyers to better monitor such practices by their suppliers and to gain more control over subcontracting.

It is beyond the scope of this study to adequately answer the question of whether buyers should be considered jointly liable for the failure of their suppliers to meet their statutory obligations to workers. Clearly this will continue to be a subject of debate between companies and trade union and non-governmental organizations.

We do, however, make the following brief observations:

- Some buyers have now accepted a number of responsibilities that are normally considered the domain of the direct employer. For instance, FLA Participating Companies have accepted the moral responsibility to ensure that their suppliers meet minimum labour standards, setting standards for hours of work, health and safety, and discrimination in hiring, despite many brands having initially resisted assuming *any* responsibility for working conditions in their supply chains. Some buyers and multi-stakeholder initiatives have also established direct lines of communication with workers and other interested parties to receive complaints about worker rights violations in supply factories.

While the acceptance of responsibility for vendor compliance and direct lines of communication between one company's workers and the buyer does not necessarily constitute a buyer's acceptance of all of the employer's responsibilities, it does mean that it is not accurate to represent the brand's relationship to the supplier and the workers as solely the role of purchaser of finished goods. The reality is much more complex.

- Further, it is worth noting that a number of leading brands that formerly refused to accept shared responsibility for violations of wage and hours of work regulations in their supplier factories now acknowledge that their own purchasing practices can contribute to such violations. However, most brands have yet to acknowledge that the downward pressure on prices paid to suppliers could contribute to a factory owner's failure to keep up to date on contributions to social security and other government programs, or that pressures placed on suppliers to meet unrealistic order deadlines could encourage unauthorized subcontracting in which such abuses are more likely to take place. Consideration of the question of buyer responsibility or liability must therefore address these underlying systemic issues in the industry that can contribute to the inability of some factory owners to meet their obligations to workers.

We have described above a number of measures that should be taken by brands to ensure that suppliers meet their legal obligations to workers in the event of a factory closure. What our study does conclude is that where buyers have failed to perform due diligence to ensure that wages, severance, social security and other legally-mandated benefits are properly funded in the event of a factory closure, it is their responsibility to account for that failure. Their shared responsibility to ensure that the workers are properly compensated should flow, at least in part, from the buyers' failure to take preventative measures that are within their power to prevent the abuse of the workers manufacturing their products.

## **APPENDIX A: Other humanitarian funds**

The Worker Rights Consortium pointed to a number of examples of similar funds that have been created in response to factory closures and the failure of the employer to provide legal compensation.

### **Rising Sun, Kenya**

At the Rising Sun factory in Kenya, which carried out a mass firing in June of 2006 without paying legal severance and back wages and later closed, the university licensee Steve and Barry's University Sportswear agreed to contribute \$20,000 to a fund for the dismissed workers. This fund was administered by the local office of the Solidarity Center with a committee of Rising Sun workers. Like the Hermosa fund, contributions to the fund were expressed as a humanitarian gesture by the licensee. Unlike the Hermosa fund, the licensee agreed to contribute to the fund within two months of receiving requests from worker representatives and despite having been in the factory for only about 3-4 months on a subcontracted basis from their direct supplier without its authorization.<sup>14</sup>

### **Evergreen, El Salvador**

At the Evergreen factory in El Salvador, which closed in January 2006 without paying severance and other compensation, Columbia Sportswear agreed to contribute \$120,000 to a fund to cover some of the unpaid debts to the workers. This case differs from Hermosa in a couple of respects. In this instance the factory machinery was liquidated to pay the debts to the workers ahead of creditors. When that was not sufficient, Columbia made its contribution based on two debts they paid directly to the workers rather than the company: 1) an amount of \$75,000 for products delivered from Evergreen but not yet paid for; and 2) \$45,000 to buy back fabric originally owned by Columbia but seized by the government when the factory closed. Both amounts were distributed to the workers by an ad-hoc commission made up of workers, management and government, and verified by the Worker Rights Consortium. Between the liquidation of assets and the debts paid by Columbia, the workers were able to receive over half of what they were owed.<sup>15</sup> One key difference in this instance was that action was taken as soon as the factory closed, making re-direction of debts and liquidation of assets a possibility.

### **Seoul International, Bangladesh**

At the Seoul International factory in Bangladesh, which closed in late 2003 without paying severance and several months of wages, Reebok required its agent, PNG, to contribute \$36,000 to a fund for the workers administered by the Bangladesh Centre for Workers Solidarity. An additional \$10,000 was contributed by the licensee Top of the World. The Seoul International workers were owed about \$312,000 US in total. The amounts received from the buyers/agents represented about 15% of what they were owed. These funds were wired within about six months of the closure. This was also characterized as a humanitarian gesture rather than a recognition of liability.<sup>16</sup>

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<sup>14</sup> Interview with Jeremy Blasi, Senior Field Representative, Worker Rights Consortium, 6 March 2007.

<sup>15</sup> Worker Rights Consortium, [Factory Assessment Update](#), 19 December, 2006, p.19

<sup>16</sup> Interview with Jeremy Blasi, Senior Field Representative, Worker Rights Consortium, 6 March 2007.

## APPENDIX B: Guarantor Provisions

There are US precedents for joint liability laws that require buyers and/or manufacturers to compensate workers when their contract suppliers fail to pay the minimum wage or legal overtime premiums.

Under section 2671 et seq. of the California Labor Code, garment companies are legally responsible as “wage guarantors” for all minimum wage and overtime compensation owed to workers by their contracted suppliers.<sup>17</sup> Notably, the law has also been used to hold a retailer who sourced private label goods accountable for workers’ wages.

The law can be legally enforced in expedited administrative wage hearings before the California Labor Commissioner’s Division of Labor Standards Enforcement (DLSE), the state agency charged with labor law enforcement. Additionally, the law may be enforced in court when the contract supplier that failed to pay minimum wage and/or overtime operated its business without a garment license required by the state.

A study of the law’s effects found that guarantors had been required to pay almost 30% of the wages paid to workers under the law. However, over 75% of cases were resolved through settlements between the workers and the contractor and/or guarantor, resulting in earlier payments but averaging only 34% of the value of the workers claims.<sup>18</sup> Even when cases proceeded to a hearing and contractors or guarantors were found liable, 60% of guarantors and 95% of contractors never paid the debts owed, and the DLSE failed to collect on most judgments. Nonetheless, the law appears to be leveraging more wage payments, particularly through settlements, than would be possible without the law.

The Augmented Compliance Program, a U.S. Department of Labor program intended to improve compliance with the US Fair Labor Standards Act in the apparel industry that includes a similar guarantor provision.

In both cases the government plays a central role in enforcing standards and adjudicating disputes. Unfortunately, in El Salvador, the complete lack of governmental responsibility and the relative lack of effective legal options for workers are key factors in the abuses at Hermosa.

Although no one MSN interviewed would argue that under current Salvadoran labour law buyers are jointly liable for the failure of their contractors or subcontractors to provide the legal minimum wage, overtime premiums or other statutory benefits, such as severance pay, the fact that such legislation currently exists in other jurisdictions would suggest that there is considerable concern about how the many-layered structure of the industry encourages such abuses of workers’ statutory rights. Guarantor provisions such as those cited above are one legal method of assisting workers in achieving redress despite the barriers created by supply chain structures.

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<sup>17</sup> California’s anti-sweatshop law is often touted as the strongest such law in the USA. However, according to the Asian Pacific American Legal Center and Sweatshop Watch, actual implementation of the law by the state labour agency has fallen short of the law’s promise; as a result, in practice, the law has been applied erratically by the state in efforts by workers to hold garment manufacturers and retailers accountable for unpaid wages of their contracted suppliers.

<sup>18</sup> Asian Pacific American Legal Center and Sweatshop Watch. [Reinforcing the Seams: Guaranteeing the Promise of California’s Landmark Anti-Sweatshop Law: An Evaluation of Assembly Bill 633 Six Years Later: Executive Summary](#). September, 2005.

While acceptance of buyer responsibility to take action when one of their suppliers fails to meet its legal obligations to workers does not necessary establish that buyers should be held jointly and legally liable for compensation owed, it is worth pointing out that, as was the case in the State of California, where soft regulation fails, hard regulation is likely to follow.