



August 25, 2006

**INTERIM SUMMARY REPORT  
THIRD PARTY COMPLAINT REGARDING  
HERMOSA MANUFACTURING, EL SALVADOR**

**Complaint**

On December 8, 2005, Christliche Initiative Romero (CIR), a non-governmental organization based in Germany, filed a Third Party Complaint with the Fair Labor Association regarding Hermosa Manufacturing, a factory located in Apopa, El Salvador. The complainant alleged that the factory had closed suddenly in May 2005, leaving about 320 workers without employment. At the time the factory closed, according to the complainant, workers were owed wages and overtime payments. Moreover, workers were not paid legally due severance pay. The complainant further stated that three FLA companies were sourcing from Hermosa Manufacturing, adidas, Nike, and Russell Athletic.<sup>1</sup>

On the same day, the FLA verified that the three FLA companies mentioned in the complaint had sourced from Hermosa in recent years,<sup>2</sup> initiated a Third Party Complaint at Step 2, and notified the complainant and the three FLA affiliated companies mentioned in the complaint (adidas, Nike, and Russell Athletic) about its action. Pursuant to Step 2, FLA companies had up to 45-days to conduct an assessment and report back to the Executive Director in writing as to whether noncompliance with the FLA Workplace Code of Conduct occurred and if so, whether and how it had been remediated.

**Assessment by Companies**

During the 45-day period that began on December 8, 2005, the FLA affiliated companies<sup>3</sup> assessed the situation and pursued discussions with stakeholders -- including Government of El Salvador officials, Hermosa workers and their union representatives, the Hermosa owner and his legal counsel, and other parties -- to try to resolve the issues underlying the complaint in a

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<sup>1</sup> The complaint also named other non-FLA companies, but the names of those companies are not used in this summary report.

<sup>2</sup> This verification was carried out by reviewing the factory lists that affiliated companies are required to submit to the FLA annually. These lists are submitted to the FLA during the first quarter of each calendar year and are updated, as appropriate, throughout the year. For 2005, Russell Athletic reported Hermosa Manufacturing as an active factory and adidas as an inactive factory (for the FLA, an active factory is defined as one where production for an FLA company is currently occurring, occurred in the last 12 months, or is likely to occur in the next 12 months); for 2004, Russell Athletic and adidas reported the factory as active; and for 2003, Russell Athletic, adidas, and Nike reported the factory as active.

<sup>3</sup>At the time the case was filed, Majestic Apparel was not affiliated with the FLA and therefore it was not involved in the case at its initiation. Majestic Apparel affiliated with the FLA as a Category B licensee in February 2006. Since its affiliation with the FLA, Majestic Apparel worked closely with the other three FLA brands in assessing the situation and seeking a resolution to the case.

manner favorable to the interests of workers.<sup>4</sup> The FLA-affiliated companies reported regularly to the FLA on their activities. On January 24, the FLA companies submitted their assessment under Step 2 of the Third Party Complaint procedure to the FLA. Among the key points from their assessment are the following:

- adidas and Nike apparel products were subcontracted to the Hermosa factory through their main contractor, Partex Apparel Group. Partex terminated adidas and Nike orders with Hermosa by mid-2003 because of persistent quality and delivery problems. During July 2004 only, a Nike licensee contracted the factory to produce a small quantity of children's wear. Russell Athletic placed production directly with Hermosa through an agent.
- 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 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 workers who led the stoppage.
- In April 2005, the union STITTAS, an affiliate of FENASTRAS, organized the factory. When the union and the owner could not reach agreement on payment for Sundays worked, the unionized workers (some 164 workers) took over 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.<sup>5</sup>
- The factory had no fund, accrual of money, or identified assets in its accounts to cover severance payments. The factory owed approximately \$750,000 to the bank that held the mortgage on the property and \$150,000 to a bank for machinery. Total worker compensation due, including unpaid benefits, unpaid salaries, and severance, is estimated at \$825,000.
- Approximately 50 former Hermosa workers were hired by a factory (MB Knitting) also owned by Hermosa's owner. These workers are still owed back wages by Hermosa. The unionized workers and a group of 64 STITTAS members who are acting independently from the union have filed 7 labor cases against the owner; there are also two criminal cases filed by the

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<sup>4</sup> A chronology of the activities related to the assessment reported by the FLA companies is at Attachment A. As is clear from the chronology, FLA companies' activities to resolve the case have continued beyond the 45-day period of the assessment.

<sup>5</sup> The "Labor Contract Suspension" provision of the Labor Law allows owners to suspend the commercial activities of the company and to leave employment contracts with the workforce in effect with respect to payment of worker compensation and benefits. This recourse is permitted to employers with no judicial supervision for up to nine months, when lack of raw materials is claimed by the employer (Articles 36 ordinal 1° and 44, Código de Trabajo, Decreto Legislativo N° 15, del 30 de junio de 1972).

Government (for failure to make full retirement and social security contributions and the misuse of such funds).

After the FLA companies filed their assessment, it was learned 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. (Although Constitutional precedence placed the claims of workers for compensation higher in priority to those of bank liens regarding the disposition of assets, there is no enabling legislation to implement the rights of workers.)

### **Report by Independent Expert Commissioned by the FLA**

On February 4, 2006, the FLA notified the complainant and the FLA companies that it was invoking Step 3 of the Third Party Complaint procedure. Pursuant to Step 3, the FLA can determine whether to proceed with further assessment through the use of either an expert or an FLA Independent External Monitor.

On March 22, 2006, the FLA contracted with an independent expert residing in El Salvador, Roberto Burgos Viale, of the Institute of Human Rights of the Central American University (Instituto de Derechos Humanos de la Universidad Centroamericana "José Simeón Cañas," IDHUCA) to "investigate and report on allegations related to the ongoing Third Party Complaint against Hermosa Manufacturing in El Salvador and produce a twenty-five- to thirty-page report in Spanish on the findings."<sup>6</sup>

On June 7, 2006, Burgos Viale submitted a draft report to the FLA in Spanish, followed the next day by a version (incomplete) in English. The Spanish version of the report, as submitted by the

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<sup>6</sup> The engagement, effective March 22, 2006, was for a term of 15 working days and due to conclude around April 15, 2006. The terms of reference for the services to be provided by Burgos Viale, incorporated in the March 22 contract, were the following: "Services shall include all activities conducted in connection with preparing for, undertaking, and writing the following:

- Report on allegations of unpaid wages and overtime payments at Hermosa Manufacturing.
- Report on allegations of unpaid severance pay and pension fund contributions at Hermosa Manufacturing.
- Report on allegations of blacklisting of former workers of Hermosa Manufacturing arising from union membership or sympathies, or any other reason that inhibits them from being hired by other plants.
- Report on legal actions taken by private parties or by the government of El Salvador that have a bearing on the resolution of workers' financial claims against Hermosa Manufacturing, including (1) law suits by banks and other institutions asserting claims to the assets of Hermosa Manufacturing; and (2) efforts by the Government of El Salvador to prosecute owners or managers of Hermosa Manufacturing for failing to make social security contributions on behalf of workers and for any other violations of law.
- Report on activities by FLA brands that sourced from Hermosa Manufacturing to find a prompt resolution to the case that is favorable to the interests of workers.

In gathering information for the report, the expert will review documents and reports and conduct interviews with a wide range of stakeholders. Among the stakeholders to be interviewed for the report are: (1) workers of Hermosa Manufacturing and their representatives; (2) civil society organizations such as GMIES, La Mesa de Maquilas, MAM/Las Melidas, and other relevant human rights or labor rights organizations; (3) management/owner of Hermosa Manufacturing and representatives of business organizations in the apparel maquila industry and related industries of El Salvador; (4) representatives of banks and other financial institutions that may hold claims on the assets of Hermosa Manufacturing; (5) representatives of the Ministry of Labor and of other government entities in El Salvador that might have jurisdiction over aspects of the case of Hermosa Manufacturing; (6) representatives of the FLA brands that sourced from Hermosa Manufacturing; and (7) representatives of the U.S. Embassy in San Salvador who have been involved in the case." The contract also included funds for translating the report into English.

expert, is at Attachment B. The FLA promptly made suggestions to the expert on the draft report with regard to specific elements of the terms of reference that had not been met and should be addressed in a final report, but these suggestions were not acted upon.<sup>7</sup> While the FLA does not concur with all aspects of the expert's report, among its main points are:

- Hermosa Manufacturing began to fall behind in payments to workers as early as the end of 2003, reportedly because international brands reduced sourcing as a result of deterioration in quality of production. Discussions between the workers and Hermosa management failed to reach a solution.
- In May 2005, when Hermosa Manufacturing closed, it owed workers pay for up to a year. These wages have not been paid as of this date. Moreover, the workers have not received other benefits they are due. (Management made deductions from workers paychecks for social security, pension, and housing fund contributions, and also for repayment of personal loans but did not make the payments to the appropriate entities. According to the workers, the amount of worker contributions deflected by management for their own use is \$350,595.)
- Hermosa workers were subject to discrimination, harassment, abuse, and excessive work hours. A group of 63 workers formed a union to pursue their rights; a strike involving unionized and non-unionized workers was deemed by the courts to be illegal.
- A group of workers pursued a criminal case against the owner of Hermosa in October 2005; as a result, Mr. Montalvo was detained.
- adidas, Nike, and Russell have approached El Salvadoran authorities to seek a solution to the case; it is also understood that the Embassy of the United States in El Salvador has also intervened to try to resolve the labor crisis. These efforts have not been successful.
- The Government of El Salvador made commitments to provide medical services to workers for a year and to organize a Job Fair, as a way to ease the severe impact on the economic situation of these workers. The workers do not report any benefit from these commitments.
- The workers' families have undergone a severe economic crisis; in some instances, they do not have the financial means to cover basic needs: food, education, medical expenses. Some have lost their homes as they have not been able to make monthly payments.
- The expert concluded that at this point, there is no likelihood of a favorable resolution for the affected workers, and their situation of vulnerability and abandonment by the Salvadoran government persists. The efforts of multinational corporations have not been successful, even though these entities are in a position from which it may be possible to find the most favorable solution for workers.

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<sup>7</sup> The FLA suggested, inter alia, that the expert include a discussion of the role played by lawsuits filed by banks, efforts by the Government of El Salvador to prosecute owners or management of Hermosa Manufacturing for failure to make legally-required social security payments, role played by FLA companies in seeking to resolve the case, and the legal framework underlying the case.

## Next Steps

As is clear from the assessments by the FLA companies conducted as part of Step 2 of the Third Party Complaint process and from the report by the independent expert engaged in Step 3, the case of Hermosa Manufacturing is very complex and aspects of it are being litigated in different arenas. Authorities of the Government of El Salvador have made commitments to address some of the more immediate needs of the affected workers but to date those commitments have not been fulfilled.

In an effort to move beyond this stalemate, the FLA intends to follow the following course of action:

1. Encourage FLA companies involved in the Third Party Complaint to continue to urge the Government of El Salvador to (a) address the immediate needs of the workers, particularly the provision of medical services to them and their families and re-employment opportunities; and (b) enforce its labor laws to obtain payment of wages and benefits (including severance) to former Hermosa workers.
2. Encourage FLA and non-FLA companies operating in El Salvador to urge their suppliers to offer employment to workers from Hermosa Manufacturing. Brands should ensure that suppliers have hiring procedures that are non-discriminatory and root out the possibility of blacklisting.
3. Remind FLA companies to ensure that contract factories have actually *paid* social security and other contributions required by domestic law (rather than just show that the amounts have been deducted from paychecks).
4. Encourage FLA companies to be more vigilant with regard to the financial ability of contract factories to pay severance and other benefits should retrenchment occur.
5. Perhaps through the MFA Forum or similar multilateral engagement, explore the possibility of establishing a financial or some other mechanism that would be available to cover all or part of the severance payments due retrenched workers.
6. Continue to monitor the situation at Hermosa Manufacturing and issue a final summary report on the case as soon as it is feasible to do so.