



Brian D. Vaughan
Senior University Legal Counsel
University of Wisconsin-Madison
500 Lincoln Drive
Madison, Wisconsin 53706

February 2, 2012

RE: adidas/PT Kizone

Dear Mr. Vaughan:

Thank you for your January 20, 2012 letter regarding the January 18, 2012 report by the Worker Rights Consortium ("WRC"). At the outset, please know that adidas values its relationship with the University of Wisconsin, and we appreciate the opportunity to respond to the WRC report, and to the University of Wisconsin's request that adidas provide an explanation (with legal support) as to why adidas is not obligated to provide compensation related to severance to PT Kizone workers and what remedial actions that adidas is willing to take.

I. adidas takes an active role to implement and enforce industry-leading standards that protect workers globally

Since 1999 adidas has had in place its Workplace Standards, which are modeled on international human rights law and international labor rights conventions. Our global inspection team (Social and Environmental Affairs) has worked collaboratively with our Global Sourcing division to monitor, evaluate and address many issues, including specifically the issue of factory downsizing and closures:

- adidas has a long standing Termination Standard Operating Procedure, which details the ethical handling of any planned order reductions or termination of our supplier relationships. Moreover, as part of our commitment to transparency, we have published these guidelines on the adidas Group website.
- adidas has prepared and issued a Handling Layoffs and Redundancies Guideline to all our sourcing partners globally. The guideline draws on international best practice for the handling of layoffs and redundancies and also specifies the minimum expectations of the adidas Group.
- adidas is tracking individual suppliers to understand the actions they are taking to manage their workforce during these challenging times, including any planned layoffs or restructuring initiatives and the impact that reduced order volumes may have on worker pay and benefits.

adidas
Legal Department
5055 N. Greeley Ave.
Portland, OR 97217

T +1-971-234-2300
F +1-971-234-4420

- adidas has reviewed and updated ourselves and our suppliers on the statutory requirements for worker dismissals and mass layoffs in each of our primary sourcing countries in Asia and have engaged with governments to understand how their response to the financial crisis will impact on enforcement practices and policies, such as minimum wage setting and social insurance.

- adidas has recently engaged with United Nation's agencies and Asian NGOs in formulating guidance for governments on the impact of the current crisis on women migrant workers.

adidas also monitors our suppliers' workplace conditions. We audit those workplaces for unfair employment practices. When there are non-compliant activities, we work with the factory to develop and execute corrective action. We conduct (ourselves and through third parties) more than 1,300 announced and unannounced audits and monitoring visits annually. It is through such efforts that we continue to act responsibly and ethically as a business, with due care and consideration for the workers who make our products.

Although adidas works collaboratively with its suppliers to ensure that they comply with our Workplace Standards, suppliers that are unable or unwilling to abide by our standards are not tolerated and we cease doing business with such suppliers.

II. adidas has no liability for any unpaid severance to the PT Kizone employees who did not receive those payments from their employer

As reviewed in more detail in the attached letter from our outside counsel, Dewey & LeBoeuf LLP, adidas believes that there is no legal basis for any claim against adidas for any liability for such severance payments under the Labor Code of Conduct ("Labor Code"), attached as Exhibit B to the Agreement dated as of November 22, 2010 between adidas America, Inc. and the Board of Regents of The University of Wisconsin System on behalf of the University of Wisconsin-Madison Division of Intercollegiate Athletics.

Briefly, the Labor Code requires adidas to contract with companies whose work places adhere to the standards and practices described in the Labor Code. Accordingly, adidas was obligated to cease dealing with any company whose work place does not comply with the standards and practices described in the Labor Code, and adidas did, in fact, cease dealing with PT Kizone. The Labor Code does not, however, impose any monetary liability on a signatory company like adidas to compensate for the fact that a contractor, like PT Kizone, does not comply with the Labor Code. Instead, the sole legal requirement imposed by the language of the Labor Code is for adidas to cease doing business with the offending company.

III. adidas wants to work with the University of Wisconsin and governmental officials on solutions that prevent illegal factory closures and support workers re-employment

While adidas is under no legal obligation to provide severance to the PT Kizone workers, adidas is very concerned about workers' rights and opposed to the actions that occurred at PT Kizone after the factory informed adidas that it was terminating its relationship with our company. Therefore, adidas has unilaterally decided to take actions that are not legally required, but which adidas believes addresses the root cause of the problem - illegal factory closures.

In furtherance of adidas' on-going commitment to stringent workplace standards, within the next sixty (60) days, adidas will contact officials from the US Trade Representative's office and US State Department in order to raise awareness concerning

illegal factory closures, the flight of factory owners and to explore whether renegade factory owners can be extradited. In addition, adidas is scheduling meetings in Jakarta with the Ministry of Trade, the Ministry of Manpower, the Korean Embassy, and the US Embassy to follow-up on the discussions we facilitated in October, 2011. Also, adidas met this week with the union representing former PT Kizone workers as part of the assistance we are providing to help displaced workers find new employment. We are pleased to report that more than 900 former PT Kizone workers have found new employment, almost 300 of them with other local adidas suppliers. We will continue to actively work to re-employ displaced workers from PT Kizone.

Simply put, we want the University of Wisconsin to partner with adidas in these efforts by not only joining us in meetings with domestic and international government officials, but by bringing its academic and political influence to bear on the situation. Let's work together to seek to eliminate illegal factory closures. We hope that the University of Wisconsin will commit to joining adidas in our efforts and collaboratively work with us to develop lasting solutions that not only prevent illegal factory closures, but also help workers who have been victimized return to work as quickly as possible. We strongly believe that by working together, the University of Wisconsin and adidas can more effectively address the issues that adversely impact workers like those at PT Kizone. Please let us know if the University of Wisconsin will join adidas in our efforts.

We look forward to discussing these matters with you further. Please do not hesitate to contact me if you have any questions concerning the above or the attached.

Very truly yours,

A handwritten signature in black ink, appearing to read 'P. Loving', with a large, sweeping flourish extending to the right.

Paul E. Loving
Special Counsel

cc: Gregg Nebel
Enclosures

DEWEY & LEBOEUF

Dewey & LeBoeuf LLP
1301 Avenue of the Americas
New York, NY 10019-6092

T +1 212 259-8000
F +1 212 259-6333

February 2, 2012

Paul Loving, Esq.
adidas Legal
5055 North Greeley Avenue
Portland, Oregon 97217

Re: University of Wisconsin

Dear Paul:

This letter summarizes our legal analysis regarding the January 20, 2012 letter to you from Brian Vaughan of the University of Wisconsin. Specifically, the letter asked adidas to provide an explanation, with legal support, as to why adidas is not obligated to provide compensation related to severance to PT Kizone workers, pursuant to the Labor Code of Conduct ("Labor Code" or "Code"), attached as Exhibit B to the Agreement dated as of November 22, 2010 (the "Contract") between adidas America, Inc. ("adidas") and the Board of Regents of The University of Wisconsin System on behalf of the University of Wisconsin-Madison Division of Intercollegiate Athletics ("University of Wisconsin").

FACTUAL BACKGROUND

1. The Contract Terms

The Contract contains provisions that make the Labor Code attached thereto as Exhibit B a part of the Contract. *See* Contract ¶ 8.A. ("As a licensee of the University, adidas agrees to comply with the requirements of the CLC Special Agreement Regarding Labor Codes of Conduct (Exhibit B), which are attached hereto, incorporated by reference, and made material to the Agreement. Any alleged breach of the CLC Special Agreement Regarding Labor Codes of Conduct (Exhibit B) shall be resolved in accord with the approach specified in Paragraph 15 of the Agreement."). Paragraph 15 of the Contract provides that "any dispute concerning the

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interpretation, construction, or breach of this Agreement shall be submitted to a mediator agreed upon by the parties for nonbinding confidential mediation at a mutually agreeable location.”

The Labor Code attached to the Contract provides that it “requires that all Licensees, at a minimum, adhere to the principles set forth in the Code.” Contract, Exhibit B, Schedule I, ¶ I. As to who is covered, the Code first provides that “the term ‘Licensee’ shall include all persons or entities which have entered into a written ‘License Agreement’ with [Collegiate Licensing Company (CLC)] to manufacture ‘Licensed Articles’ (as that term is defined in the License Agreement) bearing the names, trademarks and/or images of one or more [collegiate institutions represented by CLC].” *Id.* It further states that “[t]he term ‘Licensee’ shall for purposes of the Code, and unless otherwise specified in the Code, encompass all of Licensee’ contractors, subcontractors or manufacturers which produce, assemble or package finished Licensed Articles for the consumer.” *Id.*

As to the substantive requirements of the Labor Code, it provides: “Standards: Licensees agree to operate work places and contract with companies whose work places adhere to the standards and practices described below. CLC and the Collegiate Institutions prefer that Licensees exceed these standards.” *Id.*, Exhibit B, Schedule I, ¶ II. There is no other provision in the Labor Code specifying the extent of the Licensees’ legal obligation as to the substantive requirements of the Code. As to the standards and practices specified, the Code states that Licensees must (a) “comply with all applicable legal requirements of the country(ies) of manufacture in conducting business related to or involving the production or sale of Licensed Articles” and (b) “shall provide legally mandated benefits.” *Id.*, Exhibit B, Schedule I, ¶ II.A & II.B.

The Contract further provides that it “shall be governed by and construed in accordance with the applicable laws of the State of Wisconsin.” Contract ¶ 23. The Contract also contains an integration clause that renders ineffective any communications other than the terms set forth in the contract, or any subsequent written amendments, which we understand do not exist. *Id.* ¶ 25 (“This Agreement, together with the attached CLC Special Agreement Regarding Labor Codes of Conduct (Exhibit B) constitutes the entire understanding between the parties with respect to the subject matter hereof and cannot be amended or modified except by an agreement in writing, signed by each of the parties. All previous understandings or agreements between the parties shall have no further force and effect.”).

2. PT Kizone

The facts summarized below have been provided by adidas or, where cited, are stated in a report issued by the Worker Rights Consortium (“WRC”), dated January 18, 2012, concerning the severance issues at PT Kizone.

In June 2010, PT Kizone told adidas' buying agent, Green Textile, who then informed adidas, that PT Kizone would no longer accept orders from adidas due to production commitments to Nike and other customers.

In 2010, PT Kizone produced and shipped a total of 497,877 total units for adidas. 98.9% of the purchase orders for these units were placed by April 30, 2010. All but three of the purchase orders were communicated to and received by PT Kizone by June 30, 2010. One additional order was placed in July 2010 for 220 units and another small order for 106 pieces was placed on August 15, 2010. From January 2010 to August 30, 2010, PT Kizone shipped a total of 492,481 units to adidas.

"The violations at PT Kizone began on September 3, 2010, when it stopped paying mandatory terminal compensation to workers separated from employment." WRC Report at 2; *see also id.* at 6.

After September 3, 2010, adidas placed only one (1) small order from PT Kizone, for 60 pieces on September 14. That order was to be made from left-over fabrics and for sales samples. There is no information to indicate that adidas was aware that PT Kizone had ceased complying with the Code when it placed this very tiny order. From September 1 until its last shipment to adidas, PT Kizone shipped a total of only 5,396 units to adidas, all but 60 of which were from orders placed prior to September 3.

Between September 3 and December 31, 2010, a total of only "49 workers voluntarily left the factory's employ, but were not paid the compensation required by law and the extant collective bargaining agreement." WRC Report at 2; *see also id.* at 6.

The last shipment of goods from PT Kizone to adidas took place on November 20, 2010. Shipments to adidas from PT Kizone in November 2010 totaled 166 units.

On January 5, 2011, PT Kizone "failed to provide the factory's workers with their monthly pay for December 2010" and, on January 31, "the owner of PT Kizone, Jin Woo Kim, a South Korean national, fled Indonesia, precipitating the factory's eventual closure and leaving no money to pay severance." *Id.* at 2. These events took place after the relationship between PT Kizone and adidas had already ended.

"Green Textile, the buying agent for Nike and adidas, and the direct buyer for the Dallas Cowboys, assumed effective control of the factory's operations after the flight of the owner and kept the factory in operation for approximately nine weeks, during which time workers received their back wages." *Id.* At the end of March 2011, "the factory ceased operations." *Id.*; *see also id.* at 6-7. On April 14, 2011, PT Kizone was brought into bankruptcy following a filing by one of its creditors and its assets went into court-ordered receivership. *Id.* at 7. The proceeds of the

company's assets "are less than the amount owed to secured creditors, whose claims are, unfortunately, regularly granted precedence in Indonesia over those of workers." *Id.* at 12.

The WRC claims that "[a]t the time of final closure, on April 1, 2011, the employees were owed US\$3.4 million in total." *Id.* at 2.

As to the total number of workers claiming severance, WRC states that "2,686" employees are owed terminal compensation "according to calculations performed under the auspices of the Indonesian government." *Id.* & n.1; *see also id.* at 6. Out of the 2,686 employees claimed to be owed severance, only 49 workers had left PT Kizone by December 31, 2010 – i.e., after PT Kizone had told adidas that it would not accept any more orders from adidas, and long after the last order from adidas had been placed for just 60 units on September 14, 2010. *Id.* at 2. In other words, of the US\$3.4 million claimed owed to employees, approximately 98% would be owed to employees who were terminated *after* adidas received its last unit from PT Kizone, and had nothing to do with PT Kizone.

ANALYSIS

It is our conclusion that, under the Contract between adidas and the University of Wisconsin, including the Labor Code attached thereto, adidas has no liability for any unpaid severance to the PT Kizone employees who did not receive those payments from their employer. Most fundamentally, by their terms, neither the Contract nor the Code attached thereto imposes any obligation on adidas to make any such payments. Instead, what the Contract and Code require is that adidas, as a Licensee, cease doing any business with a contractor that does not comply with the Labor Code. According to the facts presented to us, adidas fully complied with this obligation.

Specifically, assuming that the unpaid severance was required to be made under local law, and was thus a required benefit within the standards set forth in the Code, the Contract and the Code only provide that adidas, as a Licensee, would "operate work places and contract with companies whose work places adhere to the standards and practices described." Contract, Exhibit B, Schedule I, ¶ II. There is *no* language in the Contract that imposes upon adidas any liability for, or obligation to make payments on behalf of, contractors who fail to meet their obligations under the Code. Rather, by its express terms, the Code only placed an obligation on adidas not to do business or operate a factory with a company violating the standards set forth in the Labor Code. On the facts presented, adidas complied with this obligation as (i) PT Kizone gave notice to adidas that it was terminating its relationship before any employee terminations took place; and (ii) adidas did not place any order with the offending contractor after September 14, 2010, before adidas became aware of any failure to comply with the Code by PT Kizone, and long before the vast majority of terminations (more than 98%) took place.

This conclusion, which follows from the plain language of the Contract and the Code, is fully consistent with Wisconsin law, which governs the Contract. *See* Contract ¶ 23. In Wisconsin, “[i]t is a basic principle of law, as well as common sense, that one is typically liable only for his or her own acts, not the acts of others.” *Lewis v. Physicians Ins. Co. of Wis.*, 243 Wis. 2d 648, 654 (2001). “Because vicarious liability is a severe exception to the basic principle that one is only responsible for his or her own acts, [courts] proceed with caution when asked to impose vicarious liability on an innocent party, doing so only in accordance with well-settled law.” *Id.* at 655. As Oliver Wendell Holmes, Jr., wrote, and as quoted by the Wisconsin Supreme Court (*id.* at 654 n.5), “I assume that common-sense is opposed to making one man pay for another man's wrong, unless he actually has brought the wrong to pass according to the ordinary canons of legal responsibility, -unless, that is to say, he has induced the immediate wrong-doer to do acts of which the wrong, or, at least, wrong, was the natural consequence under the circumstances known to the defendant.” *Agency*, 5 Harv. L. Rev. 1, 14 (1891).

“Under the doctrine of respondeat superior, a master is subject to liability for the tortious acts of his or her servant.” *Pamperin v. Trinity Mem'l Hosp.*, 144 Wis. 2d 188, 198 (1988); *see also* *Arsand v. City of Franklin*, 83 Wis. 2d 40, 45 (1978). However, “[a] prerequisite to vicarious liability under respondeat superior is the existence of a master/servant relationship.” *Kerl v. Dennis Rasmussen, Inc.*, 273 Wis. 2d 106, 117 (2004). Liability does not exist without such a relationship, and “[a]n independent contractor is ‘a person who contracts with another to do something for him but who is not controlled by the other nor subject to the other's right to control with respect to his physical conduct in the performance of the undertaking.’” *Id.* at 120-21, quoting Restatement (Second) of Agency § 2(3).

In short, “[a]lthough the rationale for vicarious liability has expanded and the circumstances of its application have become more diverse, the basic formula for respondeat superior has remained the same: only a ‘master’ who has the requisite degree of control or right of control over the physical conduct of a ‘servant’ in the performance of the master's business will be held vicariously liable. To impose vicarious liability where the requisite degree of control is lacking would not serve the original or more recent justifications for the rule. If a principal does not control or have the right to control the day-to-day physical conduct of the agent, then the opportunity and incentive to promote safety and the exercise of due care are not present, and imposing liability without fault becomes difficult to justify on fairness grounds.” *Kerl*, 273 Wis. 2d at 122-23.

Here, PT Kizone was an independent contractor and not in a master/servant relationship that allowed adidas to control its day-to-day actions. The fact that adidas exercised no such control is perhaps illustrated best by the fact that PT Kizone terminated its relationship with adidas months before PT Kizone started to not pay severance, and, after that, PT Kizone only filled a few residual orders for adidas as part of wrapping up and ending their relationship. There is thus no basis for imposing vicarious liability upon adidas for the acts of PT Kizone under Wisconsin law.

Paul Loving, Esq.
February 2, 2012
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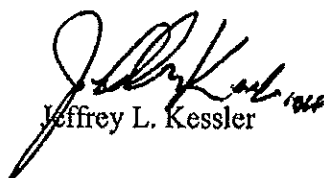
Similarly, the terms of the Contract and the Code do not impose any vicarious liability on adidas. Instead, they only provided that adidas would "operate work places and contract with companies whose work places adhere to the standards and practices described below." Labor Code, Schedule I, ¶ II. Thus, the only requirement placed upon adidas was not to do business with PT Kizone once the contractor stopped complying with the Code. adidas fulfilled any obligation under this provision when it ceased doing business with PT Kizone, and adidas thus should not have any liability either under the terms of the Contract and the Code or governing principles of Wisconsin law.

Moreover, the Contract and the Code are also clear that they do *not* apply to future conduct of a contractor, subcontractor, or manufacturer of a Licensee, *after* the Licensee has ceased doing business with such a company. Under the Contract and the Code, Licensees are defined to cover only adidas and "all of Licensee' contractors, subcontractors or manufacturers *which produce, assemble or package* finished Licensed Articles for the consumer." Labor Code, Schedule I, ¶ I (emphasis added). And, the Code's definition of required "legal compliance" only includes activities where a Licensee is "*conducting* business related to or involving the production or sale of Licensed Articles." *Id.* ¶ II.A (emphasis added). The Contract itself is also limited to oversight of "*facilities producing* goods for the University." Contract ¶ 16.A.; *see also id.* ¶ 16.C. (describing procedures if adidas "receives a complaint regarding conditions in a facility that *is producing* goods for the University") (emphasis added). Therefore, any legal compliance requirements are limited to those facilities with ongoing business related to Licensed Goods.

In this case, adidas placed its last order with PT Kizone on September 14, and the last shipment of goods to adidas from PT Kizone took place on November 20, 2010. All or virtually all of the employees were denied severance *after* adidas placed its last order and ceased dealing with PT Kizone, and there is nothing in either the Contract or the Code that makes adidas responsible for the future conduct of one of its subcontractors after adidas has ceased dealing with that company and taken its business elsewhere.

We believe adidas was in full compliance with the Contract and the Labor Code by not continuing to do business with PT Kizone, and there is no basis under the law to impose any liability on adidas for the future actions of PT Kizone after adidas ceased dealing with that company.

Sincerely,


Jeffrey L. Kessler


David G. Feher