# JAQALANKA CLOSURE REPORT

**Submitted by T-Group Solutions**
**New Delhi, India**

**with**
**CSR International**
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## Introduction:

The Fair Labor Association commissioned this assignment on May 28, 2008 to investigate and establish the causes for the closure of three factories of the Jaqalanka Group (headquartered at 46/1 Fife Road, Colombo - 5, Sri Lanka).

This assignment was carried out by Mr. Anil Sahai from T- Group Solutions located in New Delhi, with assistance from Mr. Sarath Kulasekere from CSR International located in Colombo. The fact finding mission lasted three days starting June 9, 2008. This report is a synthesis of information collected during one-on-one interviews. The opportunities to corroborate information and inspect documents were limited due to the fact that the factories had already closed and workers had dispersed.

The three factories that ceased their operations are:

- JAQALANKA LIMITED closed operations on February 7, 2008
- JAQALANKA INTERNATIONAL closed operations on February 7, 2008
- JAQALANKA APPAREL closed operations on March 17, 2008

In addition, JAQALANKA head office in Colombo ceased operations on February 7, 2008

Jaqalanka Ltd. (established in 1978) and Jaqalanka Int. (established in 1988) were located in the Katunayake Export Processing Zone (KEPZ), Sri Lanka. Both factories were hundred percent export oriented units producing woven garments. Jaqalanka Group produced garments for Nike Inc., Vanity Fair, Adidas, Jones of New York, Ms. Erika, Marks & Spencer, Old Navy, Columbia Sportswear, JC Penny, London Fog, Pacific Trail and Champion. The two factories inside the zone were unionized by the Free Trade Zones and General Services Employees Union (FTZAGSU). Jaqalanka Apparel (established in 1992) was located at Balanguda in Ratnapura and did not have any workers' union. The total number of workers in all three factories is listed in Table 1.

Table 1

| Number of Employees | Jaqalanka Ltd. | Jaqalanka Int. | Jaqalanka Apparel |
|---|---|---|---|
| As per Factory Management | 425 | 625 | 525 |
| As per Assistant Labor Commissioner's Office at Negambo | 364 | 548 | Not known |

*While the figures provided by the former Managing Director are only estimates those provided by the Asst. Labor Commissioner's office are factual.*

## Interviews:

Jaqalanka's management talked about the financial stress the factory started facing towards the end of 2005. Some of the reasons provided were escalating input costs of electricity, transportation and fuel; tightening of prices by sourcing brands and escalating wages in the KEPZ due to a shortage of skilled labor. To deal with this the factory initiated cost control measures including lean manufacturing, continuous improvement systems and modular and multi-skill operations. Despite all these measures, both factories in the KEPZ incurred financial losses during the financial year 2006-07. The factories also had problems of excessive working hours and a back-log in depositing Employee Provident Fund (EPF) and Employee Trust Fund (ETF) contributions. The management blames this on the severe cash crunch due to the limited release of funds by the lending bank (Bank of Ceylon). The bank released only ten to fifteen percent of payments received from buyers, after adjusting outstanding debts against working capital loans. Meanwhile Jaqalanka Apparel, which ran profitably, was choked for funds by the bank as it retained payments and applied them against the outstanding debts of Jaqalanka Ltd. and Jaqalanka Int.

During this time both Jaqalanka factories inside the zone were unable to meet target delivery dates. Due to excessive hours of work and delinquency in payment of statutory dues, the buyers were reluctant to place further orders. According to the management there was a break down in communication channels within the factory that resulted in a lack of motivation and productivity among workers. The last export order from Jaqalanka Int. was shipped in November 2007 and from Jaqalanka Apparel in February 2008.

The Jaqalanka Group management obtained business as sub-contractors to other suppliers in 2006. The advantage was two fold. Firstly, they could use their un-utilized capacity and secondly, the payments were made directly to the company and not via the bank, thereby reducing the cash flow problem. This arrangement however lasted for only a short duration due to the low volume and inconsistency of orders. Multiple government and non-government sources consulted in the course of compiling this report consider the financial crisis, poor marketing, low prices, the rising cost of manufacturing, poor profit margins in the wovens business and a lack of diversification as the main reasons behind many recent factory closures in Sri Lanka, including Jaqalanka. Management confirmed that there were no economic demands made by the trade union that contributed to the closure of the company.

## Labor Management Relations:

In 2003 the Joint Secretary of the FTZAGSU (formally called FTZWU: Free Trade Zone Workers Union), Anton Marcus, started organizing workers of Jaqalanka Ltd. When faced with resistance, the union launched an international campaign against Jaqalanka. That campaign led to a Third Party Complaint under the Fair Labor Association (FLA) Third Party Complaint Procedure being filed against the company by Nike Inc. In October 2003, Auret van Heerden, President and CEO of the Fair Labor Association mediated an agreement whereby management recognized the FTZAGSU as the representative of Jaqalanka Ltd. workers. It was a landmark agreement, as this was the first worker union to be recognized inside any Free Trade Zone in Sri Lanka. The Centre for Policy Alternatives was appointed by the FLA to play the role of Ombudsman. In June 2004, a meeting was held to review the eight month progress made between the union and management and both parties agreed that the process had worked successfully and they pledged to continue to work together in partnership.

Independent meetings with the union and factory management during this investigation revealed mutual respect for each other. Both acknowledged that they had negotiated in good faith on many occasions during the four years of their partnership. There had been a strike in April 2007 when the workers of Jaqalanka Ltd. and Jaqalanka Int. observed a half day strike against management's decision not to pay a bonus for 2007 (due to heavy financial losses). The bonus had been a regular benefit provided to the workers and amounted to one month's salary. The union and management negotiated and agreed to pay each worker a sum of SLR 5000 (1USD = 106 Sri Lankan Rupees) as a bonus, thereby ending the strike.

The Jaqalanka management informed the union about its financial status towards the end of 2007. Management stated to the FLA investigators that apart from mandatory wage increments as recommended by the BOI, there were no additional demands from the union that may have resulted in any financial pressure. In fact, management noticed that when the union leadership realised the financial situation they tried to explain it to the workers. In December 2007, management decided to close Jaqalanka Ltd. The plan then, was to transfer all workers from Jaqalanka Ltd. to Jaqalanka Int. However this plan did not materialize as both facilities filed for bankruptcy at the same time.

Subsequent to the closure of Jaqalanka Ltd. and Jaqalanka Int. in mid-March 2008 the workers of Jaqalanka Apparel detained two management staff on the factory premises in an attempt to get their wages paid. The management was able to clear the pending wages of all workers. The factory however owed some money to local suppliers, who in the absence of funds, signed for and took away some machines as a security against outstanding debts. The management informed the local police and insurance company of this. The liquidator appointed by the court is responsible for pursuing this matter with the relevant agencies.

A series of meetings took place between the Jaqalanka management and the worker representatives, facilitated by Mr. Somasiri from the Department of Labor and Mr. Jayasiri from the Board of Investors. Various options were discussed in order to resolve the factory closure and worker settlements. These included shifting workers of Jaqalanka Ltd. to Jaqalanka Int., an out of court settlement and a court settlement. No agreement could be reached between the parties and workers decided to take legal action to obtain their legal dues and settlements.

**Factory Closure:**

The company's lawyers moved a motion on February 5, 2008 in the District Court of Colombo to wind up the operations of Jaqalanka Ltd. *Case number: 5/2008/CO and Jaqalanka Int. *Case number: 4/2008/CO as per the Companies Act[1]. The court issued its orders the same day and nominated Mr. Lincoln Piyasena (Partner: B. R. De Silva & Company-Chartered Accountants) as the temporary liquidator. On February 6 2008, the liquidator issued separate letters to both facilities informing all employees that the operations would cease with effect from February 7 2008. Depending on the money realized by sale of the companies, workers would be notified of payment of entitlements and the dates of those payments. The liquidator explained that when a company is unable to pay its debts or clear its liabilities it needs to wind up, failing which it would be deemed to be indulging in fraudulent trade practices.

**Legal Procedures Post Factory Closure:**

The first court hearing occurred on March 29, 2008 and appointed Mr. Piyasena as the permanent liquidator. The court also ordered that the Department of Labour submit the dues sheet of the factories legal benefits, including calculations of pending payments to be made to workers for arrears, EPF, ETF and balance of salary. The labour department had papers to calculate the above for both Jaqalanka Int. and Jaqalanka Ltd, but not from Jaqalanka Apparel. Once the dues sheet is submitted to the court a judgement will be passed on dues and payments. In the meanwhile the union also submitted an application to the Labour Commissioner for compensation on account of retrenchment. The court will reach a conclusion on both dues and the application from the union.

The Deputy Labour Commissioner (Department of Labour Termination Unit) advised the union that each worker needs to apply for compensation individually within three months of factory closure. Therefore claims filed by or before May 6, 2008 only will be entertained. He also stated that workers with less than one year (180 days) of service are not entitled to termination compensation. There was no information available for Jaqalanka Apparel. The Labour Department is in the process of conducting an enquiry for all employees who applied. As per the Deputy Labour Commissioner, the process of enquiry has been completed for all workers from Jaqalanka Ltd. and Jaqalanka Int. Subsequently the detailed report, along with the compensation order, will be submitted to the District Court through the Attorney General. Thereafter the Department will pursue the matter based on the Court's decision. Since the liquidator was nominated by the court any further course of action will be based on the liquidator's assessment. Table 2 gives a breakdown of the number of applications received by the office of Deputy Labour Commissioner.

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[1] Annexure 2

Table 2

<table>
<tr><th colspan="2"></th><th>Jaqalanka Ltd.</th><th>Jaqalanka Int.</th><th>Jaqalanka Apparel</th></tr>
<tr><td colspan="2">Number of workers as per Assistant Labor Commissioner's Office at Negombo</td><td>364</td><td>548</td><td>Not known</td></tr>
<tr><td colspan="2">Union Members per Union Office</td><td>266</td><td>430</td><td>No Union</td></tr>
<tr><td rowspan="3">Number of Termination compensation claims filed per Deputy Commissioner of Labor's Office at Colombo by or before May 6, 2008</td><td>Union</td><td>266</td><td>349</td><td></td></tr>
<tr><td>Non-Union</td><td>54</td><td>32</td><td></td></tr>
<tr><td>Total</td><td>320</td><td>381</td><td>Not known</td></tr>
</table>

As per the legal procedures, the liquidator is expected to set up an inspection committee to assist in the assessment and valuation of the company's assets, plant and machinery etc. Such a committee representing the shareholders, banks and creditors was appointed for Jaqalanka Int. on June 13, 2008. Similar committees have been established for Jaqalanka Apparel and Jaqalanka Ltd. in August 2008. Once the committees are set up based on court orders, the liquidator advertises the sale of assets through newspapers. This is followed by inspection by prospective buyers who will be required to submit their offers through sealed tenders. The sale will be organized upon completion of this process. The sale proceeds will be deposited in a state bank in the 'Jaqalanka Liquidator's Account'. The entire process may take up to two years to complete[2]. The liquidator added that it may be quick to dispose of the moveable assets but finding investors for the buildings could take time. Meanwhile, according to the Senior Manager, Industrial Relations at BOI, once the liquidation process commences and after all plant, machinery and moveable assets have been disposed of, the BOI assists in finding prospective investors for the buildings. The plot sizes of Jaqalanka Int. and Jaqalanka Ltd. are approximately 2 acres and 1.5 acres respectively.

The sequence to be followed in the settlement of dues is defined in the Companies Act, No.07 of 2007. Even though legal opinion on the

[2] Some examples of other factory closures cited are:

- **Atlas Gloves (1998):** Seized operations and filled for liquidation in 1998. The liquidation process was completed within six months. There were no outstanding loans or mortgages with any financial institution. However, while the company paid all statutory dues to employees, they could only settle 22% of the termination compensation against the order issued by the office of Labor Commissioner.
- **Korea Ceylon Footwear (2002):** Went into liquidation in 2002 and all assets were sold. The proceeds realized from liquidation are still with the court. This was because both the secured creditors (Peoples Bank and Sampat Bank) who had mortgages and the union representing workers filled court cases for prioritizing their settlements. It's been six years and the matter is still pending settlement by the court.
- **Primart Industries (2004):** A footwear facility that closed in 2004. The lending bank approached the court and obtained clearance to dispose all assets mortgaged with them to recover dues towards outstanding loans.
- **Lows Garments & Knitting (2006):** Closed operations in 2006. There were no mortgages and all dues of employees were settled as per legal parameters. However, workers demanded additional compensation and that is when the BOI and department of labor intervene to mediate and resolve the matter.
- **Korea Lanka Garments (2007):** Closed operations in February 2007. There was no union and the company, with the intervention of the BOI and the District Labor office (Mr. Jayasiri and Mr. Somasiri) settled all statutory dues and negotiated for payment of termination compensation at the rate of one and a half month's pay for each completed year of service. The matter was amicably settled without taking recourse to legal proceedings in a court of law.

interpretation of certain points may be required, the sequence of payouts is as follows (in order of preference):

1. Liquidator's and liquidation committee's fee and expenses
2. Statutory dues including all EPF and ETF dues and Gratuity
3. Income and corporate taxes
4. Unpaid wages
5. Holiday pay
6. Workmen's Compensation

There is lack of clarity on the priority to be accorded to secured creditors such as banks with mortgages. The general view is that banks will get the first lien on assets mortgaged to them; however the court, in its discretion, could accord preference for settlement of statutory dues over secured creditors. The legal opinion from one of the local lawyers is as follows:

"Firstly all costs incurred by the Liquidator will be settled followed by statutory dues (e.g. employee provident fund) taxes, payments to the government etc, wages to employees (of preceding four months). With regards to bankers what matters is whether the Banker/Creditor has any asset secured in its favor. If so, the secured asset will be set aside to settle the Banker/Creditor. However there has been a recent court decision that statutory dues should be settled prior to the dues of secured creditors. There is a degree of ambiguity involved here as it is still not been authoritatively determined whether secured creditors rank in priority to the payment of statutory dues."

**Pending Dues:**

Based on estimates, facts and figures provided by the former Managing Director, Jaqalanka, Labor Commissioner's Office, BOI and Assistant Commissioner of Labor's office the payment liability of the factories is listed in Table 3.

Table 3[3]

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|---|---|
| Statutory Dues (Jaqalanka Ltd. & Jaqalanka Int.) | $218,000 approx. (EPF, ETF & Gratuity)<br>Information provided by Office of Assistant Commissioner of Labor |
| Unpaid Wages (Jaqalanka Ltd. & Jaqalanka Int.) | $72,000 approx.<br>Information provided by Office of Assistant Commissioner of Labor |
| Leave Payment (Jaqalanka Ltd. & Jaqalanka Int.) | $37,500 approx.<br>Information provided by Office of Assistant Commissioner of Labor |
| Amount Owed to Banks | $3,000,000 approx.<br>Information provided by the former Managing Director of Jaqalanka Group |
| Termination Compensation (Expected) | $600,000 approx. (for all three factories)<br>Information provided by the former Managing Director of Jaqalanka Group |

[3] A complete breakdown of the statutory benefits for Jaqalanka Ltd. and Jaqalanka Int. can be found as Annexure 3

| | |
|---|---|
| Sundry Creditors | $200,000 approx.<br>Information provided by the former Managing Director of Jaqalanka Group |
| Outstanding Down Rent owed to BOI (Jaqalanka Ltd.) | $5,057<br>Information provided by the BOI |
| Outstanding Down Rent owed to BOI (Jaqalanka Int.) | $9,189<br>Information provided by the BOI |

*Jaqalanka Apparels: Figures for statutory dues and leave payment not available: Taking an estimated amount of $125,000*

The total pay-out figure is expected to be approx. $4,140,746. This does not include the fees/expenses of the liquidator. As per the factory management there are no pending corporate or government tax liabilities. Table 4 highlights the estimates of available resources and proceeds expected through liquidation. These are estimates based on calculations provided by the factory management.

Table 4

| | |
|---|---|
| Pending VAT Claims | $100,000 |
| Estimated value of buildings inside the KEPZ | $750,000 to $1.00 million approx. |
| Estimated value of land and building of Jaqalanka Apparel | $450,000 approx. |
| Estimated Value of Plant & Machinery (includes approx. 1000 machines old, new and specialized, power generating sets, boilers and finishing equipment etc.) | $500,000 approx. for all three factories |
| Estimated value of other assets | $75,000 approx. |
| Estimated value of land in Colombo which the management is thinking of disposing to settle the dues | $600,000 approx. |

The liquidation process could generate a total of $2,725,000. There will therefore be a short-fall of funds to meet the liabilities listed above. Nevertheless, the directors have a personal liability towards EPF and ETF dues through separate laws enacted for these categories and they will be personally liable if these statutory dues are not cleared[4]. While Jaqalanka management anticipates that the company owes $3,000,000 to the bank, they are not sure of the extent of mortgage liability with the bank. The status of priority in the payout of statutory dues to employees will only be clear once the extent of assets mortgaged to the bank is known. However, as indicated earlier, the court may grant preference to the payments of statutory dues over secured creditors.

The settlement of dues is now dependent upon the speed with which the liquidation process moves ahead. It is imperative to expedite this process because the longer it takes the higher the fees and expenses of the liquidator will be and they will be drawn from the same pool of funds on a first priority basis.

[4] The relevant sections of the law are attached as Annexure 4

**Current Employment Status of Retrenched Workers:**

Per discussions with the union, BOI, Office of Assistant Labour Commissioner and Jaqalanka management, it appears that most workers in both factories have since found employment. Management informed the investigators that the union office bearers were line leaders in their respective areas of work and were highly skilled. These workers should therefore not have any problem in finding jobs. The BOI is of the opinion that if the workers had not found employment post closure they would have protested at the office of the Labour Commissioner and the BOI but this had not occurred so they are assuming that the workers have found jobs. It may be difficult for older workers (40+ years) to find a job in the industry, but due to acute shortage of labour most workers are likely to get absorbed in the industry. The General Secretary of the union says he expects that the remaining workers will also find employment shortly as there is a shortage of approximately 30,000 skilled workers in the apparel industry. According to the union, some workers employed in Jaqalanka Ltd. from the beginning have gone back to their villages as it is difficult for them to find job in the garment industry given their age. At the time of the closure some union members faced difficulties in finding jobs given their union affiliation but most of the union members have since found a job. There are a few (approx 10) union members who have not been able to find employment. The union secretary has come across only one case where a union member was hired by a factory and then laid off when the management got to know about his union affiliation. On the last Sunday of each month the union holds a meeting with the ex- workers to give them an update on the legal proceedings.

**Conclusion:**

Based on the information gathered in this investigation, the following factors contributed to the closure of the Jaqalanka factories:

- The export-oriented woven garments business has increasingly become financially unviable in Sri Lanka.
- The acute shortage of skilled labor in Sri Lanka, especially in the KEPZ area, has resulted in an exceptional escalation of wage rates. In addition, companies have to provide extra benefits to retain workers.
- The increasing costs of raw materials, fuel, electricity and transportation, combined with the tight pricing structure of the industry, further impacted the viability of the company.
- The decision by the bank to withhold payments to offset working capital loans resulted in a cash flow crisis for Jaqalanka Ltd. and Jaqalanka Int.
- The company’s persistent problems with hours of work and failure to deposit mandatory dues for EPF and ETF led to violations of buyer codes of conduct standards on working hours and wages and benefits that eventually led to the decision by some buyers to cut ties with the group.

There is no evidence to suggest that demands or pressures emanating from the trade union contributed in any way to the closure of the Jaqalanka facilities. This was confirmed by the owner of Jaqalanka.

**Recommendations and Next Steps:**

1. The Jaqalanka management should obtain information pertaining to statutory dues and leave payment for Jaqalanka Apparel from the appropriate labour office.
2. The Jaqalanka management should obtain the final status of the assets mortgaged with the bank and their approximate value.
3. The Jaqalanka management as part of the liquidation committee should regularly follow up with the liquidator and the court to expedite the liquidation process.
4. The Jaqalanka management should seek BOI's assistance in identifying potential investors for the two facilities in the KEPZ.
5. The Jaqalanka management should obtain information on final termination compensation for all workers (union members and non union members) for all three factories from the office of Commissioner of Labor.
6. The union should obtain information on final termination compensation for all union members for Jaqalanka Int. and Jaqalanka Ltd from the office of Commissioner of Labour.
7. The union and the management should continue dialogue with all stake-holders until the final settlement is reached.
8. FLA should closely monitor the process.

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