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泰乐信律师事务所

Labor Contract Law Promulgated

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On June 29, 2007, the Standing Committee of the National People's Congress promulgated the long-awaited *Law of the People's Republic of China on Labor Contracts (Law)*. The Law will enter into effect on January 1, 2008.

The prior drafting process which relied heavily on public comments had led to widespread interest among both enterprises and their workforce. The Law generally applies to all employment relationships, including labor contracts between foreign investment enterprises and their staff. Exceptions may apply as per special regulations.

Employers should carefully review their existing employment structures, labor contracts and other labor related policies, staff hand-books and manuals and prepare for the implementation of the new Law.

The first draft of the law triggered almost 200,000 comments from the public – more than any other draft law so far.

As outlined below, the Law may also have significant financial implications. Given the introduction of e.g. substantial penalties in case of various violations, employers in China will face pressure to comply with the Law's 98 Articles. Compared to the previously often relaxed approach by many – in particular local – companies, full compliance may lead to increased overheads and ultimately in an increase of prices for products originating from China. It can be expected that in the coming months, strong public information campaigns will be made via the State-controlled Chinese media. Further implementing regulations also on the local level might still be promulgated.

On the next pages you find some highlights regarding the new Law.

Employment Handbooks

The formulation of and changes to company-internal rules having a direct bearing on the interest of its employees (e.g. on work hours, rest and leave policies, training, work discipline, etc.) needs to be carried out through consultations with the labor union or employee representatives “on the basis of equality”. The rules must be made public or be notified to the employees. The Law provides for complaint procedures. Employers should consider publishing respective internal rules before January 1, 2008.

Written and Oral Labor Contracts

The Law has clarified that a labor relationship exists, without exception, as of the day the employer factually starts using the employee. In general, a written labor contract must be concluded latest within 1 month thereafter. Each employee is entitled to keep one original set of his/her labor contract. The deadline to conclude a written contract for employees engaged without a written document before January 1, 2008, is January 31, 2008. Oral contracts are, however, permitted in case of part-time workers (in average not more than 4 hours/day and not more than 24 hours/week).

IMPORTANT: Incompliance with the requirement to conclude a written contract leads to the employer’s obligation to pay double salary to the employee. In case no written contract is concluded within one year after the employer has started using the employee, the employment relationship is deemed to be open-ended.

Fixed and Open-ended Contracts

The parties to a labor contract can generally agree to either a fixed or open-ended duration. However, an open-ended contract must e.g. be agreed upon in case of:

- Continuous employment with the same employer for more than 10 years
- Renewal after prior conclusion of two fixed-term contracts (whereby fixed term contracts entered into before January 1, 2008, will not count)

In general, no differences can be noted e.g. regarding the termination rights between the two contract types (different from earlier drafts of the Law).

IMPORTANT: If the employer fails to conclude an open-ended contract where required, the employee is entitled to a double salary.

Probation Period

Only one probation period is permitted, which needs to be specified in the contract. The maximum length depends only on the employment duration:

| Duration | Probation period |
|-------------------------------------|------------------|
| Less than 3 months | Not permitted |
| 3 months – 1 year | Maximum 1 month |
| 1 year – 3 years | Maximum 2 months |
| More than 3 years / open-ended term | Maximum 6 months |

The salary during the probation period may not be lower than the lowest wage level for the same job, or 80% of the salary agreed for the period afterwards, but in any case may not be lower than the minimum salary applicable at the employer’s location.

Termination

The Law contains detailed rules in which cases a labor contract may be terminated. In general, they mirror the existing laws and local regulations, with the exception of e.g. the following newly introduced / revised rules:

- Termination by the employee during the probation period requires a 3-days advance notice without reason
- The reasons for termination must be explained to an employee (also) in case of termination by the employer during the probation period
- Termination by the employer is permitted without notice period in cases of a parallel employment with another employer, if completion by his employment tasks are affected or the employee has not rectified the situation after being notified by the employer
- The Law contains somewhat more detailed rules on mass lay-offs (reduction by more than 20 people, or more than 10% of the total workforce), including re-employment obligations

Terminations by the employer (except terminations for cause) are now, among others, also prohibited if

- an employee exposed to work-related health risks has not undergone a pre-departure health-check, is diagnosed with a work-related disease or under medical observation, or
- if the employee has worked for the same employer for more than 15 years and is less than 5 years away from reaching the retirement age

Role of Labor Unions during Termination

The labor union must be notified of any unilateral termination by the employer and the reasons in advance. The labor union may request a rectification, in which case it must be notified how the matter has been handled. It can be expected that this procedure will strengthen the role of the labor unions. However, the Law fails to expressly state whether a violation of this special procedural requirement leads to an automatic invalidity of the issued termination notice.

Severance Payments after Termination

Similar to the present law, severance payments must be made to an employee in cases of ordinary termination by the employer with 30 days notice as well as termination by the employee for cause. Severance payment is also required,

- If the employer proposes a termination and the parties have agreed on a termination agreement
- In cases a fixed-term contract expires, unless the employee has not agreed to a prolongation despite being offered the same or better terms than those in the expiring contract

The severance payment is calculated in the following way:

| Length of employment | Compensation amount |
|---|--------------------------------------|
| Number of full years worked with the employer | 1 month salary for each year of work |
| A period of more than 6 months to one year | 1 month salary |
| A period of less than 6 months | 1/2 month's salary |

A "month's salary" means the employee's average salary for the 12 months prior to termination or expiry of the contract.

IMPORTANT: There is generally no cap in the Law on the severance amount, except:

- If the employee's monthly salary is more than 3 times the average monthly salary ("Cap Amount") of the employer's location as officially published, the maximum severance payment is based on the Cap Amount. It may not exceed compensation for 12 working years.

Termination against the law triggers a right of the employee to be re-employed, or additional compensation obligations by the employer, namely payment of twice the stipulated severance amount.

Non-compete Clauses

Post-contractual non-compete clauses continue to be permitted, provided an employee has a confidentiality obligation. The maximum non-compete period is 2 years (i.e. the expected reduction from the presently permitted 3 years).

The Law has clarified that financial compensation during the non-compete period shall be paid on a monthly basis, but fails specifying the minimum amount of such compensation.

However, the scope, territory and term of the non-compete obligation must be clearly spelled out and may not violate other laws and regulations.

Training Agreements

Training agreements, specifying a loyalty period after "professional technical training" with "special funding", continue to be permitted, somewhat similar as under present laws.

Certain restrictions on such agreements contained in earlier drafts of the Law have been eliminated by the legislator. In case of termination before the expiry of the loyalty period, the employee must pay the agreed liquidated damages, which may not exceed the actual training fees, which are linearly reduced during the loyalty period.

Labor Service Companies

The involvement of labor service companies is regulated in more detail than before.

Labor contracts between staff and such labor service company seconding the employee to the factual employer must have a fixed term of at least 2 years. Multiple short term secondments to the factual employer are prohibited.

- In general, such secondment arrangements shall only be used for temporary, auxiliary or substitute jobs
- It is doubtful that the secondment related rules also apply to secondments by FESCO or similar organizations of staff to a foreign resident representative office (the proposed applicability of the Law to employment relationships for representative offices was dropped in the finally promulgated Law)

Part-time Employment

As explained above, oral contracts are permitted for part-time employees. It is prohibited to stipulate a probation period. Part-time labor contracts may be terminated by either party at any time. The hourly compensation must be above the locally prescribed minimum wages and payment of wages to a part-time employee must be made at least on a semi-monthly basis.

Supervision by the Labor Authorities

The local labor and social security bureaus are authorized to carry out “monitoring inspections”, during which they may review employment related contracts and documents and conduct further on-site inspection work. Employees are expressly permitted to report infringements of their rights to the authorities, besides other forms of dispute settlement (labor arbitration / litigation).

Statutory Liability and Administrative Sanctions

The Law contains various prohibitions targeting to reduce the known existing incompliances of many – in particular local - employers. Violation leads to express statutory liabilities:

- Employers are e.g. liable for damages caused by (i) company rules violating laws and regulations, (ii) lacking of the prescribed minimum content in labor contracts, (iii) in case of an invalid contract, (iv) failure to issue a termination certificate, or (v) hiring of an employee who has not yet ended his previous labor contract (towards the old employer)
- Penalties can be imposed by the authorities e.g. in cases where (i) an employee’s ID card or other papers are kept by the employer in violation of the law, (ii) security deposits are collected from an employee, (iii) wages are not paid in time or below the locally stipulated minimum levels, or are not paid for overtime, or severance payments after termination/expiration are not paid (where the penalty in each of the cases may be between

50-100% of the unpaid amount)

- In serious cases of violations of the Law, besides statutory liability of the employer, fines of up to RMB 5,000 per person shall be imposed, and the competent Administration for Industry and Commerce shall revoke the employer’s business license

Grandfathering Rules

The supplementary provisions of the Law clarify that labor contracts concluded prior to January 1, 2008 continue to be valid. We understand that the contents of the Law will, however, generally apply to such employment relationships as of January 1, 2008.

In cases where a person employed before January 1, 2008 is (under the Law) entitled to severance payments previously not granted, his/her respective working years will – for purpose of calculating severance payments - only start to count as of January 1, 2008.

If there is a severance entitlement based on the present law, such law applies even if the termination / expiry of the contract occurs after January 1, 2008.

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Conclusion

The promulgation of the Labor Contract Law marks an important step in the ongoing development of Chinese labor laws and regulations.

12 years after the Labor Law entered into effect in 1995 which remains in effect, the legislator has now made substantial revisions to certain and introduced some new rules.

The various penalty and compensation clauses aim at increasing the pressure on employers to comply with the various employee-protecting rules. Although several of these rules have already existed for many years, the level of implementation in practice was often rather thin.

In the future, employers will need to think twice whether they indeed still want to e.g. employ staff without written contracts (and correspondingly not pay social security for the employees), refuse to conclude open-ended contracts or withhold the payment of severance upon termination / expiry despite a respective statutory requirement.

Labor unions and staff representatives will play an increasingly important part, e.g. regarding formulation of company rules and terminations.