AKIN GUMP
STRAUSS HAUER & FELD LLP
美国艾金·岗波律师事务所

May 4, 2009

# CHINA ALERT

## THE 10 MOST COMMONLY HELD MISCONCEPTIONS ABOUT LAYOFFS IN CHINA

**SUMMARY**

- Chinese law is very restrictive regarding employee layoffs, recognizing only a few statutory grounds for termination of their employment contracts
- Under Chinese law, layoffs involving more than a few employees are permitted only on two legal grounds: mutual separation and economic layoff
- Mutual separation requires employee consent, and the severance must be higher than the statutory minimum, unless the separation is initiated by an employee's resignation
- "Economic layoff" requires a) consultation with the union or all employees and b) advance notice to the local government
- Both mutual separation and economic layoff require good planning and proactive communication
- Instead of keeping the government in the dark until a crisis develops, a smart employer initiates communication with the local government before the redundancy plan is implemented.

When reduction of workforce is inevitable, employers should do so within the bounds of law to avoid labor disputes and negative media coverage. This requires a good strategy, careful planning and well-coordinated implementation, all based on a full understanding of relevant Chinese laws and regulations and their interrelationship. This is not as simple as it sounds since Chinese laws are by no means straightforward. On the contrary, their ambiguous language often disguises hidden hurdles. To help our clients navigate the legal maze and formulate effective strategies, we have prepared this guide.

*This document is distributed for informational use only; it does not constitute legal advice and should not be used as such.*
© 2009 Akin Gump Strauss Hauer & Feld

akingump.com

**1. So long as a company is not doing well, it can downsize its workforce at will.**

***Wrong.*** Overall, Chinese law is restrictive when it comes to an employer's right to terminate employment. Under the PRC Employment Contract Law (ECL), employers are not allowed to unilaterally, i.e., without the employee's consent, terminate an employee's contract before its term expires unless it is justified on statutory grounds. The statutory grounds are divided into three categories, covered by Articles 39, 40 and 41 of the ECL respectively. They are: 1) employee's "fault," 2) the parties' "inability" to perform employment contract and 3) "economic layoff." In fact, after taking away those grounds that can only be applied in very limited circumstances,[1] there are only six grounds left. They are—

(1) Employee has failed to meet recruiting qualifications during his or her probationary period.[2]

(2) Employee has seriously violated company rules or has seriously neglected his or her duties or engaged in obtaining unlawful interest through fraudulent activities, and such act caused significant injury to the employer.[3]

(3) Employee is incompetent and remains incompetent after training or change of position.[4]

(4) Material changes to the objective economic circumstances relied upon by the parties at the time of conclusion of the employment contract have made it impossible to perform the contract, and the parties cannot agree on revising the contract through negotiation.[5]

(5) The company is experiencing serious difficulties in production and operation.[6]

(6) Other material changes to the objective economic circumstances relied upon by the parties at the time of conclusion of the employment contract have made it impossible to perform the contract.[7]

As the following paragraphs shall explain, these six grounds all contain very restrictive requirements. None of them is easy to satisfy. Grounds 1 through 4 are intended to be used for individual terminations and, therefore, are difficult to be used for layoffs involving more than a few employees. Grounds 5 and 6 are more suitable for layoffs in a bad economy, but they require additional procedures. This makes termination on consent (mutual separation) a more desirable option. However, as shall become obvious in the following section, mutual separation is not as simple as many people would believe.

[1] These limited-use grounds are: for category 1, a) the employee has seriously neglected duties or engaged in fraudulent acts, which caused significant injury to the company; b) the employee's employment with another employer has seriously affected his performance; c) the employment contract is void *ab initio* because the employee was hired as a result of his fraudulent or coercive acts; and d) the employee is criminally prosecuted; for category 2, the employee has suffered illness or non-work-related injury and, after expiration of statutory medical treatment, is unable to resume original work or different work arranged by the company; for category 3, a) the company is undergoing reorganization during bankruptcy; and b) the company switches production, introduces a major technological innovation or revises its business method, and, after amendment of employment contracts, still needs to reduce its workforce.

[2] ECL, Art. 39.

[3] ECL, Art. 39.

[4] ECL, Art. 40.

[5] ECL, Art. 40.

[6] ECL, Art. 41.

[7] ECL, Art. 41.



*This document is distributed for informational use only; it does not constitute legal advice and should not be used as such.*
© 2009 Akin Gump Strauss Hauer & Feld

**2. Mutual separation is always an easily available cost-saving option to the employer.**

***Wrong.*** Pursuant to Article 46 of the ECL, the employer is required to pay statutory minimum severance *even in a termination by mutual separation, if the termination is requested by the employer*.[8] Therefore, the employer is relieved of the obligation to pay statutory minimum severance only if the employee unilaterally resigns.

Therefore, in the most typical mutual separation, the employer should be prepared to pay a higher amount of severance than the legal minimum. The benefit in paying the "premium" on top of the legal minimum in a mutual separation, as compared to paying the legal minimum in a unilateral termination, is that the employee is not likely to challenge the termination later.

**3. It is easy to terminate an employee individually on the grounds that the employee has failed to meet recruiting qualifications during the probation period.**

***Wrong***. First, termination on this ground must be made *before* the probationary period expires, not *after*. Under the ECL, the probationary period is one month if the contract is for three months through one year, two months if the contract is between one year and two years, and six months if the contract is for three years or longer. In all cases, the period is short and the deadline easy to miss.

Second, in a dispute over termination on this ground, the labor arbitrator often requires that the employer prove that the employee fails to meet the job requirements listed in the job description (JD) section of the employer's recruiting advertisement or offer letter. The requirement must be specific enough to avoid arbitrariness on the part of the employer. For instance, "good language skills" may be interpreted by an arbitrator to mean Chinese language only, not including English, while "good communication skills" may not be specific enough to measure an employee's failure to communicate to colleagues through e-mail. "Team spirit" is also too general a term to be of much use. This means that the employer must anticipate in the JD all possible qualities that it would want employees to have, and it must quantify such qualities through measurable standards.

**4. It is easy to terminate an employee on the grounds that the employee seriously violated company rules or committed serious neglect of duty or fraudulent acts.**

***Wrong.*** First, violating company rules is not easy to prove, as both the ECL and a Supreme Court judicial interpretation require the employer to prove that the company rules were adopted after consultation with the trade union or "all employees."[9] For companies that do not have trade unions yet, this procedure will pose a serious logistical problem.

Second, while neglect of duty is not difficult to prove, what constitutes "serious" neglect of duty is uncertain under current law. Furthermore, "significant injury" to the company is often difficult to prove.

---

[8] ECL, Art. 46.
[9] ECL, Art. 4. Judicial Interpretation on Trial of Labor-Related Matters (II).



*This document is distributed for informational use only; it does not constitute legal advice and should not be used as such.*
© 2009 Akin Gump Strauss Hauer & Feld

**5. It is easy to terminate employees individually on the grounds that "the employee is incompetent."**

***Wrong.*** First, the ECL allows the employer to terminate an incompetent employee only after providing him or her with training or an alternative position and then finding that he or she remains incompetent.[10] In practical terms, this means the employer has to prove the employee's incompetence twice.

Second and more importantly, arbitrators typically require objective and quantifiable standards to measure an employee's performance. They also often require such standards be expressly included in the employment contract of the employee so that the latter is on notice. Unfortunately, most employers find it impractical to do so. The result is that performance evaluations such as "inability to meet the target," "inability to communicate" or "inability to work with the team" are often found by arbitrators to be inadequate to support a finding of incompetence.

**6. It is easy to terminate employees individually on the grounds that their positions are eliminated.**

***Wrong.*** An employer can rely on this ground only if, after "negotiation," the parties are still unable to agree on revising the contract.[11] This term is interpreted by labor arbitrators to mean that the employer must offer the employee a different position but may terminate the contract only if the employee refuses to take the offer. What if the employer does not have an alternative position fitting the employee? After all, most employers would not consider terminating the employee if an alternative position existed for him or her, given the cost of training an experienced employee. But the ECL is silent on this point, and no subsequent regulation has filled the gap. As a practical matter, if the employer has not offered an alternative position and terminated the employee, the latter would prevail in a subsequent labor arbitration challenging this ground, and the arbitrator would have to find the termination unlawful.

**7. There is no need to report to the local labor bureau before implementation of a redundancy plan.**

***Wrong.*** First, Article 41 of the ECL clearly provides that an employer may reduce the workforce in such circumstances *only after it has reported* the workforce reduction plan to the labor department, i.e., the local labor bureau.[12]

Second, local governments are increasingly imposing the same or even more rigorous requirements.[13]

Third, even if there is no local requirement, communicating with the government before implementing the redundancy plan is a good strategy. Rather than waiting until after the government learns about the layoff from the media—in which case the government may be

---

[10] ECL, Art. 40(2).
[11] ECL, Art. 40(3).
[12] See Box "Prior Report Required."
[13] See Box "Prior Report Required."



*This document is distributed for informational use only; it does not constitute legal advice and should not be used as such.*
© 2009 Akin Gump Strauss Hauer & Feld

under enormous media pressure to "play tough"—the company should act proactively by explaining to the local government beforehand why the layoff is necessary and what the company has done to help its employees. Once the company wins the government's sympathy, a hostile reaction from the media or the unions is much less likely.

**8. The reporting requirement for employee layoffs can be met by a phone call to the local labor bureau.**

***Wrong.*** Many local governments require employers to include in the report detailed information such as the total number of employees to be laid off, their names and positions, information on the severance package, the company's reason for the layoff (e.g., losses suffered), etc. Employers may have reservations about disclosing such information out of concerns for confidentiality or for the company's reputation—saying the company is in bad shape may help to justify layoffs to the government, but it may also cast negative light on the company's performance in the eyes of investors. Therefore, employers may feel an urge to dispense with the matter by a brief phone call to the local labor bureau. But from the local government's point of view, this is often not enough. It has a legitimate concern over how layoffs from a major employer will impact local employment. In fact, city governments are often required to report in detail significant local layoffs to the provincial government.

Communicating with local government is an art. A company can file the report as a formality. Or it can use the opportunity to win the ears of the local government. Just as it is important to obtain the government's help when a company first makes an investment, so is it equally important to seek the government's sympathy when it considers downsizing. Where possible, the company should establish and maintain a relationship with the local labor bureau based on regular and frequent contact. So long as the company shows respect and sincerity, most local officials will, at least, *try* not to make things more difficult. Through informal but patient discussion, the two sides may find a solution through which the labor bureau's fact-finding responsibilities are satisfied without disclosing too much of what the company does not want formally disclosed.

**9. It is easy to meet the "union/employees consultation" requirement under Article 41 of the ECL.**

***Wrong.*** Many employers fail to give adequate consideration to the requirement that the employer must explain the situation to the trade union or "all employees" at least 30 days before the layoff date and consider their opinions. Generally, this provision poses two difficulties for employers.

The first has to do with timing. Contrary to what many employers mistakenly believe, the 30-day notice *cannot* be substituted by adding an extra month's salary to the employee's severance. The "payment in lieu of notice rule" does not apply to layoffs under Article 41 of the ECL. Therefore, if you are laying off employees within the meaning of Article 41, you must leave enough time (at least 30 days) between the notice date and the "last day at work" for the employees. Of course, employers may be concerned that giving 30-day notice to employees would give some of them enough time to "make trouble." Here, having a trade union will be an enormous advantage to the company. Delivering the layoff plan to a trade union chairman and hearing the union's comments are, logistically, much easier and simpler than interacting with "all employees."



*This document is distributed for informational use only; it does not constitute legal advice and should not be used as such.*
© 2009 Akin Gump Strauss Hauer & Feld

The second difficulty involves what an employer must do if it does not have a trade union. In that case, the employer must find a way to communicate with "all employees." It is difficult but not unachievable. The important thing is that the company's HR staff (or whoever is going to communicate the layoff) should have a script prepared or reviewed by the legal department.

**10. So long as a statutory ground exists, an employer can terminate any employee in compliance with the ECL.**

***Wrong.*** Article 42 of the ECL imposes a prohibitive restriction on the right of employers to terminate an employment contract even if the employer can find a statutory ground in Article 40 or Article 41, i.e., where the employee has committed no "fault". This prohibition applies to the following employees—

(1) an employee who was exposed to occupational disease hazards and has not undergone a pre-departure occupational health checkup, or who is suspected of having contracted an occupational disease and is being diagnosed or under medical observation

(2) an employee who has lost or partially lost capacity to work due to an occupational disease contracted or a work-related injury suffered while at work

(3) an employee who has contracted an illness or sustained a non-work-related injury, and the statutory medical treatment period has not expired

(4) a female employee in her pregnancy, confinement or nursing period

(5) an employee who has been working for the employer continuously for no fewer than 15 years and is less than five years away from his or her legal retirement age.

Thus, an employer should check whether the list of employees to be laid off includes anyone falling within one of the five categories above, especially those in (4) or (5).



*This document is distributed for informational use only; it does not constitute legal advice and should not be used as such.*
© 2009 Akin Gump Strauss Hauer & Feld

## SHANGHAI HIGHER COURT ISSUED OPINIONS ON ECL

In March 2009, the Shanghai City Higher Court issued its "Opinions on Certain Issues in Application of the Employment Contract Law" (the "Shanghai Court Opinions"). It reflects a national trend for local governments to take the initiative in addressing the various questions raised in the implementation of the Employment Contract Law. In fact, the Shanghai Court Opinions contain rules similar to those found in the draft of the Supreme People's Court "Interpretations on Certain Issues Related to the Application of Law in the Adjudication of Labor Disputes."

The following is a summary and explanation of some of the rules from the Shanghai Court Opinions that are most relevant to foreign companies operating in Shanghai.

- When a fixed-term contract is renewed after two continuous terms, the employer is required to convert it into a non-fixed-term contract only if the employer has decided to renew it and the employee requests such conversion.
- Employers may include in the employment contract the same kind of duties that are found in company rules; these are binding on employees.
- Employers have no liability for double wage if failure to enter into a written employment contract is caused by an employee's refusal to sign the contract.
- If an employee continues to work after a contract has expired but refuses to renew it after good faith efforts by the employer, the contract is deemed to have been unilaterally ended by the employee. The employer is then obligated to pay wages, but not severance.
- Where the contract term expires but is extended by law (e.g., when a woman employee is within the period of pregnancy, maternity leave, or lactation), and the employee's time of continuous employment within the extended period has exceeded 10 years, the requirement for converting the contract into a non-fixed-term contract does not apply.
- Where the employment contract expires before the training bond period expires, the employer has the right to request that the employee continue working until the end of the training bond.
- Employers have the right to request repayment of a special allowance—arguably including the sign-on bonus—or return of fringe benefits if an employee terminates the employment contract before it expires.
- Where the parties have stipulated non-compete provisions but failed to stipulate compensation or a compensation amount, the non-compete clause would remain binding on the parties. If the parties fail to agree on the amount, the amount should be set at 20 to 50 percent of the normal wage of the employee.
- The pre-ECL 12-month cap on severance for terminations based on incompetence or mutual separation remains effective for the period of employment before January 1, 2008.



*This document is distributed for informational use only; it does not constitute legal advice and should not be used as such.*
© 2009 Akin Gump Strauss Hauer & Feld

**PRIOR REPORT TO GOVERNMENT REQUIRED BEFORE LAYOFFS**

Recently, an increasing number of local governments in China have adopted policies requiring employers to report to the government before they finalize or implement their redundancy plans. This requirement caught many HR and legal professionals by surprise. Many thought that the Employment Contract Law merely required the employer to report to the government its redundancy plan *subsequent* to the layoff. Indeed, a circular recently issued by the PRC State Council only requires employers to report their redundancy plans in a "timely" fashion, but does not specify when this should be done. However, a careful examination of Article 41 of the ECL itself clearly reveals that an employer is allowed to lay off 20 employees or 10 percent of the workforce only *after* it reports its redundancy plan to the local labor department.

Regardless of what the ECL really means, local governments have made the requirement clearer and tougher to meet. In some cities, such as Beijing, the government only requires a "timely report." But in many more localities, such as Shanghai, Wuxi, Suzhou, Guangdong, Guangzhou, Fujian, Liaoning, Shenyang, Dalian, Hebei, Henan, Hubei, Hunan and Hainan, the government requires reporting the redundancy plan to the government 15 to 30 days before implementing the plan. Some cities have lowered the reporting threshold. Suzhou, for instance, requires that an employer report its redundancy plan to the government if it involves more than 5 percent of the workforce at one time or 10 percent of the workforce, cumulatively, within a year. Other cities have introduced tough measures to penalize employers who fail to report in advance. In Guangzhou, for example, an employer who fails to report in advance would not be allowed to discontinue its social security contribution after the employee's departure.

## CONTACT INFORMATION

If you have questions concerning this alert or labor and employment issues in China, please contact—

Chris Xiaoyun Lin ........... 86.10.8567.2238 ........................... clin@akingump.com ................................. Beijing
Yuanming Wang .............. 86.10.8567.2221 ........................... ymwang@akingump.com .......................... Beijing

If you have general questions about Akin Gump's China practice, please contact—

Eliot R. Cutler.................. 86.10.8567.2210 ........................... ecutler@akingump.com ............................ Beijing
Janet Jie Tang .................. 86.10.8567.2220 ........................... jtang@akingump.com ................................ Beijing

*This document is distributed for informational use only; it does not constitute legal advice and should not be used as such.*
© 2009 Akin Gump Strauss Hauer & Feld