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CHINA LABOR AND EMPLOYMENT ALERT

CHINA'S NEW EMPLOYMENT CONTRACT LAW

AKIN GUMP

On June 29, 2007, the Standing Committee of the National People's Congress (NPC) approved the long-awaited Employment Contract Law (ECL), also known as the Labor Contract Law. The ECL took effect on January 1, 2008. Since the ECL's antecedent, the Labor Law, was promulgated in 1994, hundreds of lower-level regulations and rules have

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been enacted by the State Council or the various ministries, including the Ministry of Labor and Social Security (MOLSS), to attempt to regulate employment matters. In terms of its hierarchy in the Chinese legal regime, the ECL is the second major law to regulate employment contract issues.

Except for the employment situations of civil servants working for the government and of workers hired by a family, the ECL is intended to be applicable to employment contracts with all types of employers in mainland China, including state-owned enterprises, privately owned enterprises, foreign invested enterprises (FIE) and governmental agencies and organizations (regarding employees other than civil servants). Hence, the ECL has to take into consideration a wide employment gamut, ranging from blue-collar workers to white-collar employees working at foreign invested enterprises, and attempt to provide relevant protections to all these employees.

Overall, the ECL inherits the provisions and spirit of the Labor Law, previous labor regulations and rules, and judicial interpretations of the Labor Law. By contrast, however, the ECL explicitly imposes penalties on employers for failure to sign written employment contracts with employees, encourages employers to sign long-term employment contracts, expands individual employee rights and protections, and strengthens collective rights and collective negotiations.

As is the case with most Chinese laws and regulations, numerous provisions within the ECL remain vague or ambiguous, subject to further clarification by implementation rules or judicial practice. For instance, as will be discussed below, it remains unclear whether the China representative offices of foreign companies can directly hire Chinese employees. Implementing regulations that are expected to be promulgated may provide further details. Nevertheless, we have learned that the Chinese government has determined that the implementation regulations will be promulgated by the State Council, but not at the level of the MOLSS. As such, the implementation regulations will proceed from a higher level of authority than rules promulgated

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by the MOLSS. That said, it will also take a longer time for the State Council to promulgate regulations, as more procedures will need to be involved, including meetings at various levels and at various ministries to discuss drafts, as well as General Meetings of the State Council to conduct the final review and obtain approval.

The real impact of this ECL will depend upon how diligently and uniformly the government enforces it. In particular, the ECL provides both the national and local governments with the authority to oversee and administer its implementation. Whether all levels of government will be diligent in ensuring compliance with the ECL and whether the national government will make it a priority to ensure consistent application of the ECL nationwide are open questions whose answers will determine the success or failure of this initiative.

The following are some of the more important provisions of the ECL:

1. Individual Employment Contracts

The ECL reiterates the requirement under the Labor Law that a written employment contract shall be signed, and that an employer must sign a written employment contract with its employee within one month after the employee begins work.¹ The ECL also explicitly states that, in the case of part-time employees, no written employment contract is required.

In contrast to the Labor Law, the ECL requires an employment contract that treats not only those terms originally required under the Labor Law (such as contract duration, job description, working protections and working conditions, remuneration and benefits, working disciplines, circumstances under which the employment contract may be prematurely terminated and damages for breach of contract), but also terms such as working hours, vacations, social security and protections against occupational hazards. In addition, the ECL gives employer and employee the flexibility to negotiate and decide whether or not to stipulate other matters such as probation, training, confidentiality, additional insurance and other remunerations in the employment contract.

Furthermore, the ECL explicitly stipulates the consequences for failure to sign a written employment contract within the statutorily required time frame. If no written employment contract is signed one year after the employee's work, the employer is deemed to have entered into an open-ended employment contract² and shall pay double wage to the concerned employee.³

2. Fixed-Term versus Open-Ended Contract

The ECL follows the provisions of the Labor Law to distinguish among three types of employment contracts:

- fixed-term contracts
- open-ended contracts
- contracts based on the completion of an assignment.

An "open-ended employment contract" means that the contract has no expiration date. The Labor Law used to provide that no severance payment was required when an employment contract expired. Therefore, an employer naturally

¹ See Article 10 of the ECL.

² See Article 14 of the ECL.

³ See Article 82 of the ECL.

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preferred signing fixed-term contracts, because it would not have to make severance payment when an employee's contract expired and the employment was not renewed. This is changed by the ECL, which explicitly provides that an employer must pay severance payment to its employee at the time of the lawful termination of an employment contract, unless the employee does not agree to renew the contract even though the terms offered by the employer are the same as or better than those stipulated in the current contract.⁴

In contrast to the Labor Law, wherein an employee can ask to sign an open-ended employment contract only if he has been employed for 10 consecutive years by the same employer and then only with the employer's consent to renew the contract, the ECL imposes the obligation on each employer to sign an open-ended employment contract with its employee under the following circumstances—

- (1) an employee has worked for the same employer for 10 consecutive years;
- (2) when the employer initially adopts the employment contract system or when a state-owned enterprise re-concludes the employment contract due to restructuring, the employee has already worked for this employer for 10 full years consecutively and is less than 10 years away from his legal retirement age⁵;
- (3) an employee has completed two fixed-term employment contracts (regardless of the length of the contracts) with the same employer (unless the employee has engaged in serious misconduct or is not physically competent to carry out the job responsibilities according to Article 39 and Article 40 of the ECL); or
- (4) no employment contract is signed one year after the employee's work.

For a fixed-term employment contract, the ECL does not provide a minimum contract duration. But the length of an employment contract makes a difference in terms of the probationary period.⁶

3. Probationary Period

In contrast to the Labor Law, which merely provides that a probationary period shall be no longer than six months,⁷ the ECL strengthens the protection to employees in this regard by providing that—

- (1) no probationary period is allowed for an employment contract of less than three months or for an employment contract based on the completion of a designated assignment
- (2) the probationary period shall not exceed one month for employment contracts of three months to one year
- (3) the probationary period shall not exceed two months for employment contracts of one year to three years
- (4) the probationary period shall not exceed six months for employment contracts of more than three years or for open-ended employment contracts.⁸

⁴ See Article 46(5) of the ECL.

⁵ See Article 14 of the ECL.

⁶ See Article 19 of the ECL.

During the past decade, some local labor rules (such as Beijing Labor Contract Rules) developed this requirement and required various probationary periods shorter than six months based upon different terms of employment.

⁸ See Article 19 of the ECL.

While the Labor Law provides that an employer may terminate the employment contract with an employee who is under probation and unable to meet the hiring conditions, the ECL adds stringent requirements on such contract termination. It provides that, unless certain statutorily required conditions arise, an employer cannot terminate the employment contract with an employee during the employee's probationary period.⁹ These statutorily required conditions include: the employee is proved to fail to meet the hiring conditions; the employee materially breaches the employer's rules and regulations; the employee commits serious dereliction of duty causing material damage to the employer; the employee is concurrently employed by another employer; the employee is convicted of a crime and sentenced with a criminal penalty, etc.¹⁰

Other employee protections regarding the probationary period include: an employer can only have one probationary period for each employee¹¹, and the salary of an employee on probation shall not be lower than the minimum salary for the same position with the same employer or not lower than 80 percent of the salary stipulated in the employment contract with the concerned employee, nor may it be lower than the minimum salary of the place where the employer is located.¹²

4. Democratic Procedures Required for Making of Company Rules/Codes of Conduct

The ECL imposes a democratic procedural rule on an employer's adoption or amendment of its rules and codes of conduct directly related to employees' interest such as remuneration, working hours, vacation, safety and health, insurance and welfare, training and discipline. Under the ECL, before adoption of such rules and codes of conduct, an employer must complete the following three steps¹³—

Step 1: Discussion. The employer shall discuss its draft rules at the "employee representative congress" or a meeting of all employees, and the employees may raise proposals to and make comments on the draft;

Step 2: Negotiation. The employer shall discuss with the labor union or the employee representatives the formulation or revision of rules that involve the interests of the employees; and

Step 3: Public announcement or notification. The employer shall make public or otherwise communicate to all of its employees, e.g., by holding a meeting, any rules that have an impact on them.

If an employer fails to follow these procedures, the government may order it to rectify the situation; the employer shall also indemnify the employees should it cause damage to employees.¹⁴

In the implementation of rules and codes of conduct, the labor union or employees are entitled to request consultation and amendment if it or they deem certain rules inappropriate.¹⁵

As to whether or to what extent an employer must accept or follow the proposals and comments on draft rules and regulations raised by labor unions, employee representatives or employees, the ECL does not provide full clear guidance. Most of the officials with whom we spoke believe that such provisions of the ECL only require an employer

⁹ See Article 21 of the ECL.

¹⁰ See Articles 21, 39 and 40(1) and (2) of the ECL.

¹¹ See Article 19 of the ECL.

¹² See Article 20 of the ECL.

¹³ See Article 4 of the ECL.

¹⁴ Some Chinese legal experts observe that the obligation here is merely to consult, but not to reach agreement. It is conceivable, however, that employees might claim that procedures were not followed when a particular proposal is not accepted.

¹⁵ See Article 4 of the ECL.

to perform the democratic procedures for formulating or amending its employment management rules and regulations. These officials tend to believe that the employer will be in a leading and controlling position in determining internal rules and regulations.

5. Competition Restrictions

Unlike the Labor Law, which provides no detailed rules for competition restrictions, the ECL explicitly states that competition restrictions shall not exceed two years following employment termination and may only apply to senior management, technical personnel and employees with a confidentiality obligation.¹⁶

In exchange for non-competition covenants by the employee, an employer may make financial compensation to the employee. In contrast to existing regulations on non-competition issues,¹⁷ the ECL makes it clear that such compensation must be paid in monthly installments during the post-termination non-competition period.¹⁸ But the ECL does not provide any guidance on how to determine the amount of the compensation.

6. Termination of Employment with Severance Payments

Under the ECL, an employee may terminate the employment contract with severance payments from the employer under the following circumstances—

- (1) the employer fails to provide working protection or working conditions as stipulated in the employment contract;
- (2) the employer fails to pay adequate remuneration to the employee in a timely manner;
- (3) the employer fails to pay social security for the employee;
- (4) the employer's rules and regulations break the law and cause harm to the employee;
- (5) the employment contract is invalid because it was concluded, contrary to the employee's interests, through deception, coercion or exploitation by the employer;
- (6) other circumstances provided by law.¹⁹

The ECL provides that an employer may terminate an employment contract with severance payment to the concerned employee in the following situations:

- (1) when the employer asks the employee to terminate the contract and the employee accepts; 20
- (2) when, after the prescribed period of medical care for an illness or non-occupational injury, the employee is unable to perform his original job duty and still fails to perform other job duties arranged by the employer;²¹

¹⁶ See Article 24 of the ECL.

¹⁷ There are certain local regulations addressing non-competition issues; the Labor Law is silent on this matter.

¹⁸ See Article 23 of the ECL.

¹⁹ See Article 38 of the ECL.

 $^{^{20}}$ See Article 46(2) of the ECL.

²¹ See Article 40(1) of the ECL.

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- (3) when the employee is incompetent and remains incompetent after training and adjustment of his position;²²
- (4) when a major change has occurred in the objective circumstances under which the employment contract was entered into, and such change has frustrated the purpose of the original employment contract, and the employer and employee fail to reach a new agreement following negotiations;²³
- (5) when economic layoff occurs in case of reorganization of the employer in accordance with the PRC Bankruptcy Law; ²⁴
- (6) when a fixed-term employment contract expires, except if the employee refuses to renew such fixedterm employment contract albeit the employer maintains the same or more favorable offer to the employee;²⁵
- (7) when the employer is declared bankrupt in accordance with the PRC Bankruptcy Law;²⁶
- (8) when the employer has its business license revoked, is ordered by the government to close or is dissolved;²⁷
- (9) circumstances as specified in Article 38 of the ECL;²⁸
- (10) other circumstances provided by law.²⁹

In all of the above situations, the employer must provide a severance payment of one month's wage for each full year of service rendered by the concerned employee (less than a full year but greater than six months shall be counted as one full year).

Different from the Labor Law, the ECL adds that an employee is entitled to severance payment when a fixed-term employment contract expires. Additionally, the ECL imposes a cap on the severance pay by providing that, if an employee's average monthly salary exceeds three times the average wage of all employees in the municipality where the employer is located, the severance pay will be capped at three times the average municipal salary and the total amount of severance pay in this situation is capped at 12-months' salary.³⁰ These caps appear to reduce significantly the separation costs of senior management employees or high-salary professionals, as well as the severance entitlements of long-term employees.³¹

Parenthetically, the question of whether the 12-month cap applies to employees whose salary does not exceed three times the average municipal salary is an open one and subject to further clarification.

²² See Article 40(2) of the ECL. ²³ See Article 40(2) of the ECL.

 $^{^{23}}$ See Article 40(3) of the ECL.

See Article 46(4) of the ECL.

 $^{^{25}}$ See Article 46(5) of the ECL.

²⁶ See Article 46(6) of the ECL.

²⁷ See Article 46(6) of the ECL.

 $^{^{28}}$ See Article 46(1) of the ECL.

²⁹ See Article 46(7) of the ECL.

The labor regulations used to require that severance pay be based on the *actual* salary of the relevant employee.

³¹ The Labor Law also provided severance of one month per year of employment, but it only had the 12-month cap, not the three-times-the-average-municipal-wage cap.

If an employer terminates an employment contract in violation of the provisions of the ECL, the employer shall pay the employee twice the severance payment to which the employee is entitled.³²

Additionally, an employer must notify the labor union in advance of the reasons for its unilateral termination of an employment contract. The labor union may request the employer rectify the matter if the labor union believes the employer violated the law or the employment contract (in such a case, the employer shall review the comments made by the labor union and notify the labor union in writing of its decision).³³ The ECL is silent, however, regarding instances where there is no labor union.

7. Termination of Employment Without Severance Payment

An employment contract may be terminated without incurring severance payment to the concerned employee in the following circumstances—

- (1) the employee resigns;
- (2) the employee does not meet the hiring requirements during the probationary period;
- (3) the employee materially breaches the rules and regulations of the employer;
- (4) the employee's behavior results in a "serious dereliction of duty," or can be considered "graft" causing "substantial damage to the employer";
- (5) the employee is concurrently employed by another employer, which seriously affects the employee's job performance, or he refuses to rectify the situation after the employer's request;
- (6) the employee concludes the employment contract by means of deception or coercion; or
- (7) the employee, according to a judicial investigation, bears criminal blame.

As discussed above, the ECL requires that, in all cases where an employer wants to terminate employment contracts, the employer, in advance, must notify the labor union of the reasons for the termination. The labor union may then request the employer to rectify the matter if the labor union believes the employer violated the law or the employment contract (in such a case, the employer shall review the comments made by the labor union and notify the labor union in writing of its decision).³⁴

8. Employees Protected from Termination

The ECL protects several categories of employees from termination of their employment contracts, including-

- (1) employees who have been exposed to occupational disease dangers and who have not undergone a pre-departure occupational health exam, or who are suspected of having contracted occupational diseases and are currently under observation or being diagnosed
- (2) those who lost the ability to work due to industrial injury or occupational disease

³² See Article 87 of the ECL.

³³ See Article 43 of the ECL.

³⁴ See Article 43 of the ECL.

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- (3) those who are in the midst of a set period of medical care (even for non-work-related injuries or diseases)
- (4) those who are pregnant or nursing
- (5) those long-serving employees (i.e., at least 15 years of employment) who are less than five years away from retirement.³⁵

In addition to the preceding, there is also a catchall clause in the ECL suggesting that there may be additional categories of protection against termination, perhaps to be published in subsequent regulations. In this regard, the ECL provides more protections to employees than the Labor Law.

9. Economic Layoff

Under the ECL, economic layoff (defined as laying off 20 or more employees, or laying off fewer than 20 but more than 10 percent of an employer's total workforce) is allowed only in the following situations—

- (1) the employer is reorganized as a result of bankruptcy;
- (2) the employer encounters serious difficulties in production or operation;
- (3) the employer changes production, makes important technological innovation or adjusts the form of business operation, and it is still necessary to cut down the number of employees after the employment contract is changed; or
- (4) a major change occurs to an objective economic circumstance under which the employment contracts were entered into, and, as a result, it is not feasible to fulfill the employment contracts.

In these situations, the employer must provide a 30-day prior notice to the labor union, explain the layoff and provide an opportunity to learn the labor union's or employees' views. Additionally, the employer must report the workforce reduction plan to the governmental labor authority.³⁶

The following employees are entitled to priority of being retained during the economic layoff-

- (1) those who have concluded relatively long-term fixed-term contracts with the employer
- (2) those who have concluded open-ended contracts with the employer
- (3) those who are the only breadwinners in families with minors or elderly family members.³⁷

If the employer hires again within six months after the layoff, the laid-off employees are entitled to be hired on a preferential basis under the same conditions offered to other people.³⁸

³⁵ See Article 42 of the ECL.

³⁶ See Article 41 of the ECL.

³⁷ Compared to the Labor Law, these new provisions expand the grounds on which economic layoff is permitted, but at the same time the ECL imposes more procedural requirements.

³⁸ See Article 41 of the ECL.

10. Labor Dispatch Services

Under the existing law, foreign companies' China representative offices cannot directly recruit Chinese employees from the Chinese market and must go through those employment agencies, such as the Foreign Enterprise Service Co., Ltd (FESCO), designated by the Chinese government. As a result of such legal restrictions, strictly speaking, the employment agencies are the employer of the relevant employees who are dispatched by them to the China representative office of foreign companies, and there is a separate contract between the employment agencies and the China representative office under which the Chinese representative office will pay various service fees to the employment agencies for the latter's service of dispatching Chinese employees to the China representative office.³⁹ Even companies, such as foreign invested enterprises, that are legally capable of directly hiring Chinese employees, from time to time will use the employment agencies to procure employees. They will do so for various reasons, such as avoiding the legal obligations attendant on being employers.

One of the issues most heavily debated during the law-making process of the ECL concerned whether or not a foreign company's China representative office should be allowed to directly hire Chinese employees, and what function the employment agencies should play. We learned that employment agencies such as FESCO were arguing fiercely that they should still be the sole channel for representative offices to hire staff. After much debate and as a result of compromise among the various interest groups, the ECL is silent on these issues (our source indicates that these issues may still be open and the upcoming Implementation Regulations of the ECL may address these issues).

Nevertheless, the relevant provisions of the ECL indeed indicate that limitations are adopted for employment agencies and that their role will no longer be providers of complete workforces for any entity, but, instead, providers of only "temporary, auxiliary, or substitute positions."⁴⁰ Legislative authorities are still in the process of clarifying such issues as the meaning of "temporary." The latest information indicates that the term of a dispatch may not exceed six months; otherwise, the accepting entity must directly hire the concerned employee.⁴¹

The ECL also explicitly provides that employers may not establish employment agencies to place workers with themselves or their affiliates.⁴²

With regard to the labor dispatch services, the ECL also specifies some protections to employees, such as (1) employment agencies are required to sign minimum two-year contracts with employees to be dispatched;⁴³ (2) employment agencies shall not pocket part of the labor compensation that the employment-accepting entity pays to the employee according to the labor dispatch agreement;⁴⁴ (3) employment agencies shall pay employees at least the monthly local minimum wage even when employees are not assigned to a workplace;⁴⁵ (4) employment agencies shall pay employees at least the same salary as employees who are hired by the company that receives the labor dispatch

³⁹ Also according to the Judicial Interpretation of Supreme People's Court issued in 2006, the representative office of a foreign enterprise and the employment agency shall be held jointly and severally liable to the employees if there is any legal liability incurred.

⁴⁰ See Article 66 of the ECL.

⁴¹ According to a news report dated December 26, 2007 (www.sina.com.cn), the Legislative Affair Committee of the Standing Committee of the NPC issued a reply to the Ministry of Labor and Social Security providing its interpretation of Article 66 of the ECL. According to the report, the NPC holds that, if an employer uses dispatched employees for any of its posts for more than six months, it must directly hire the concerned employees.

⁴² See Article 67 of the ECL.

⁴³ See Article 58 of the ECL.

⁴⁴ See Article 60 of the ECL.

⁴⁵ See Article 58 of the ECL.



services to perform the same job;⁴⁶ and (5) employees are entitled to join the labor unions of the employment agencies or of the company that receives the labor dispatch services.⁴⁷ These provisions will likely affect employment agencies' costs, which may result in higher costs for companies seeking to hire staff from them.⁴⁸-

In the months to come, special attention will need to be paid to the evolution of Chinese law regarding the issue of labor dispatch services.

11. Part-time Employment

Under the ECL, a part-time employee is defined as someone whose remuneration is mainly calculated by the hour and whose average working hours do not exceed four hours per day, or 24 hours per week, for the same employer.⁴⁹

The ECL requires that the compensation for part-time labor may not be lower than the local minimum hourly wage rate, and payment to the employee must be made at least once every 15 days.⁵⁰ Additionally, no probationary period is allowed in the case of part-time employment.⁵¹

In contrast to full-time employees, part-time employees are subject to termination of their employment at any time. Additionally, their employer does not have to pay severance pay to the part-time employee at the time of employment termination.⁵² Additionally, it is not mandatory for the employment contract to be in writing; a verbal contract is allowed.⁵³

12. Collective Employment Contracts

Employees may sign collective employment contracts with the employer to cover matters such as remuneration, working hours, vacation, safety and health, insurance and social welfare. The labor union will represent the employees in signing a collective employment contract with the employer. If there is no labor union established at the employing entity, it is the labor union at the next higher level that will guide the employees to negotiate and sign the collective employment contract with the employer.⁵⁴

Under the ECL, industry-wide collective employment contracts are allowed in certain industries such as construction, mining and food services at the county level and below.⁵⁵

Before being signed, the draft collective employment contracts must be submitted to the employee representative congress for discussion and consent.⁵⁶

A collective employment contract must be submitted to the government authorities in charge of labor administration (MOLSS or its local counterparts); the government authority is entitled to raise objections within 15 days of receipt of

 $^{^{46}}$ See Article 63 of the ECL.

⁴⁷ See Article 64 of the ECL.

⁴⁸ The Labor Law did not provide for such rules and regulations regarding labor dispatch services.

⁴⁹ See Article 68 of the ECL.

⁵⁰ See Article 72 of the ECL.

⁵¹ See Article 70 of the ECL.

⁵² See Article 71 of the ECL.

⁵³ See Article 69 of the ECL.

⁵⁴ See Article 51 of the ECL.

⁵⁵ See Article 53 of the ECL.

⁵⁶ See Article 51 of the ECL.

the contract. If no objections are raised, the collective employment contract becomes effective at the end of the 15-day period.⁵⁷

13. Damages for Breach of Contract

Under the ECL, liquidated damages payable by an employee to his employer are allowed in an employment contract only in the following two situations—

- the employee breaches a confidentiality-related competition restriction covenant; or
- the employee breaches the minimum service period established after the employee receives professional training funded by the employer.⁵⁸

The ECL also provides that an employee shall indemnify the employer if he causes damages to the employer by unlawfully terminating his employment contract or by breaching the confidentiality obligation.⁵⁹ This indicates that the employer may still be able to request indemnification from the employee if the employee causes damages to the employer, but such indemnification shall not be in the form of any liquidated damages stipulated in the employment contract.

14. Training

As noted above, an employer may require its employee to serve a minimum time period if the employer provides to the employee professional technical training with the "specially designated funds" of the employer. In this case, liquidated damages are allowed in the relevant employment contract for the employee's failure to complete the minimum service period. But the liquidated damages shall not exceed the total amount of the funds spent by the employer for the concerned employee's training.⁶⁰

⁵⁷ See Article 54 of the ECL.

⁵⁸ See Articles 22, 23 and 25 of the ECL.

 $^{^{59}}$ See Article 90 of the ECL.

⁶⁰ See Article 22 of the ECL.

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