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China Employment Law Update - January 2007

Baker & McKenzie

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Abstract
An update in ongoing developments regarding labor relations and employment in China.

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Andreas Lauffs
Head
China Employment Group
+852 2846 1964
andreas.lauffs@bakernet.com

China's Employment Contract Law – Second Draft Contains Major Changes

On December 24, 2006, the Standing Committee of the National People's Congress conducted the second reading of the proposed Employment Contract Law (劳动合同法). The Standing Committee reviewed a draft (the "Second Draft") prepared by the Law Committee of the NPC that differed substantially from the draft that was submitted to the NPC in December 2005 and released for public comment in March 2006 (the "First Draft").

The Law Committee draft was prepared after considering more than 191,000 comments received from the public.

The Law Committee will likely make only limited revisions based on feedback obtained from the second reading. Expectations are that the NPC may approve the law this spring with the new requirements becoming effective later in the year.

The changes in the Second Draft generally favor employers, in part, due to a reduction in the role of labor unions. Nevertheless, the draft law on balance represents a significant increase for the protection of employees in comparison to current law. The law also remains a piece of legislation generally applicable to all employees, from the shop floor through general managers. Drafters rejected a proposal that was seriously considered this summer to exempt senior managers from the law.

Despite the extensive redrafting, the draft law still suffers from numerous instances of vague language. As a result, many provisions are subject to multiple interpretations, thereby reducing their effectiveness in providing reliable guideposts for employers to follow in managing their workforces.

Significant aspects of the Second Draft are discussed below:

Fixed-term contracts remain discouraged

The Second Draft retains the requirement in the First Draft that employers must pay severance to employees whose fixed-term contracts are not renewed. The Second Draft, however, added an important exception to this rule. Employers would not be required to pay severance when an employee rejects an extension offered by the employer that contains terms at least equal to the terms currently enjoyed by the employee.

The Second Draft allows only two fixed-term contracts. If an employer wants to continue employing an employee after the expiration of the second

www.bakernet.com

Beijing
Suite 3401, China World Tower 2
China World Trade Centre
1 Jianguomenwai Dajie
Beijing 100004, PRC
Tel: +86 10 6535 3800
Fax: +86 10 6505 2309

Shanghai
Unit 1601, Jin Mao Tower
88 Century Boulevard, Pudong
Shanghai 200121, PRC
Tel: +86 21 6105 8558
Fax: +86 21 5047 0020

Hong Kong
14/F Hutchison House
10 Harcourt Road
Central, Hong Kong
Tel: +852 2846 1888
Fax: +852 2845 0476

term, an open-term contract must be signed at the request of the employee. This requirement reflects the government's intent to encourage long-term employment.

The Second Draft, however, deleted a provision in the First Draft that gave employees without written contracts the right to demand open-term contracts. In addition, the new draft restored provisions in current law that fixed-term contracts may be terminated by employers when employees are shown to be "incompetent".

More flexibility on employer rules

The Second Draft modifies, but does not substantially clarify, requirements regarding the procedure for issuing company rules. The rules subject to the procedure are rules that have a "direct bearing on the immediate interests" of employees, such as compensation and work hours. Examples of such rules would commonly be found in employee handbooks and codes of conduct.

The Second Draft no longer contains the requirement from the First Draft that proposed rules require union approval. Instead, the rules must be first discussed by all employees or by an "employee representative congress" before being determined through consultations" by the employer and a union or employee representatives.

The extent and nature of the required "consultations" are not defined. Thus, it is not clear whether merely notifying or seeking the opinions of employees is sufficient. "Consultations" could be interpreted to require negotiations between employers and employees.

These "consultation" procedures would also apply to "material matters" affecting the interests of employees. As a result, even if the issuance of a company rule is not involved, employers apparently could be required to negotiate with employees or unions when contemplating major changes in policies affecting all employees.

Two new provisions create rights to challenge rules issued by employers. First, unions and individual employees may file objections with employers if they believe implemented rules are "inappropriate". The rules should then be "improved" after "consultations", thereby creating the possibility that the rules are unenforceable until employees or unions have provided their consent following another round of negotiations with employees.

The second new provision gives the labor bureau the right to order an employer to change company rules that violate applicable laws and to indemnify employees from any losses suffered by the employees resulting from the employer's enforcement of these rules.

Simplified probationary periods

The Second Draft eliminates a cumbersome proposal in the First Draft that tied maximum probation periods to the type of position of the employee. Instead, the Second Draft takes a simpler approach by linking maximum probation periods to the lengths of the terms of contracts. The maximum probation periods are:

Under one year:	one month
One year to three years:	two months
More than three years/open-term contract:	six months

These limits would modify current national rules on probation periods as well as many local regulations that specify maximum periods.

The Second Draft requires employers to pay employees at least 80% of their contractual salaries during probation periods. This new requirement is a compromise between preventing the relatively common practice of paying employees at far lower rates during probation while giving employers a legal method of reducing the cost of employees who may not be fully productive during probation periods.

Less guidance on non-compete requirements

The Second Draft reiterates current law that post-termination compensation must be paid to a former employee in order to enforce a non-compete restriction. The new draft, however, does not fill in a gap in the current law by specifying a required amount of compensation.

Limits on the amount of liquidated damages were also removed, thereby permitting the parties to agree on damages employers could recover if employees violated non-compete restrictions. The damages could only be reduced if a court later found that they were clearly excessive.

New provisions regarding secondment contracts

The Second Draft requires that the initial employment contracts between seconded employees and labor service providers, such as FESCO or CIIC, be at least two years. These contracts must be renewed unless there are grounds to terminate the secondees for cause. As a result, the contracts for secondees in effect may amount to open-term contracts.

The Second Draft also provides that secondment shall "generally" be practiced for temporary, auxiliary, or substitute job positions. The list of positions will be announced later, thereby creating the possibility that secondment may be permitted only for employees in non-core positions or in certain industries.

One change may result in increased costs for employers to use seconded employees. The Second Draft provides that seconded workers have the right to receive "equal pay for equal work." This rule may require employers to increase salaries of seconded employees to meet those of direct hires and effectively prohibit two-tiered wage systems. Employers, however, would be permitted to reduce the pay of seconded employees to the minimum wage during periods of no work.

Expanded scope for mass-layoffs

The Second Draft significantly expands the possibility that employers may terminate employees through mass layoffs. Terminations would now be possible when performance of contracts becomes impossible because of changes in economic circumstances. This termination ground creates the possibility that employers and employees could agree in employment contracts that certain business conditions are essential to the performance of employment contracts, and that any change to the conditions would be grounds for a mass layoff.

The possibility that mass layoffs could be implemented in practice, however, is tempered by new provisions that may give most employees the right to claim priority from termination. Priority under the Second Draft are given to

employees with long terms of service, employees with long fixed-term contracts, employees with open-term contracts, and employees who have families to support.

The Second Draft also requires that at least 20 employees or 10 percent of total staff be terminated during a mass layoff. Current law does not require a minimum number of affected employees for a mass layoff.

Requirements for training contracts slightly reduced

The Second Draft reduced from six months to one month the minimum length of training that an employer must provide to an employee under a training contract in order for an employer to recover training expenses from employees who do not serve required terms of service. However, the Second Draft retains other requirements from the First Draft that the training must be off-the-job professional technical or vocational training. Thus, employers likely could not recover expenses for in-house training programs or tuition for academic programs.

A translation of the Second Draft is available from Baker & McKenzie upon request.