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China Employment Law Update - December 2015

Baker & McKenzie

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Beijing Issues Implementation Measures on Labor Union Law

On November 27, 2015, the Standing Committee of the Beijing Municipal People's Congress adopted the *Measures for Implementing the Labor Union Law of the People's Republic of China* ("**Measures**"), which will take effect on January 1, 2016. The Measures are likely to impose additional costs and further administrative burdens on companies in Beijing. Some of the key changes include the following:

- Employee Notification in Mass Layoffs

  The Measures provide that the company should inform all employees of the mass layoff plan "through an employee representative council or through an all-employee meeting", as well as listen to the opinions of the company union or all employees. The national law does not require the company to convene an employee representation council or an all-employee meeting for the purpose of discussing the mass layoff plan, particularly if the company already has a union. Therefore, mass lay-offs in Beijing would become more onerous under the Measures.

- Union Fee

  The Measures state that if the employees have shown a willingness to establish a company union, then the company should pay a union preparation fee (equivalent to 2% of the company's total salary), from the date when the upper-level union starts to provide assistance in establishing the union. Under the national law, the union fee is payable from the date that the union is established. Previously, the local Beijing tax authorities and Beijing chapter of the All-China Federation of Trade Unions tried to push all companies without a union to pay a union preparation fee, but the new regulations make clear that only companies that have begun the union establishment process need to pay such a fee.

- Collective Bargaining

  The Measures provide that if the company union or other employee representatives request collective bargaining with the company, the company cannot refuse or delay the bargaining for any reason. Under national law and local regulations in several cities (such as Shanghai), the company may refuse to engage in collective bargaining for a "justifiable reason". The term "justifiable reason" is not defined in the law but generally is interpreted very narrowly

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(e.g., the company is about to be shut down). According to the Measures, it appears that the company would be obliged to conduct collective bargaining irrespective of any difficulties, if the employees present such a request.

- Penalties for Violation of the Measures

  The Measures provide that if the company breaches the Measures (e.g. by obstructing employees from establishing a union, refusing to engage in the collective bargaining process, etc.), the authorities may demand the company to rectify the breach, and if the company still fails to comply, the labor bureau may include this information in their records, and the administration of industry and commerce may include this in the public credit information index. This may potentially limit the company's ability to participate in government procurement activities, bidding for government projects and in receiving government subsidies, etc.

Key Take-Away Points:

In light of the changes under the Measures, companies in Beijing should be prepared for union establishment or collective bargaining requests from employees, and should follow the new procedural requirements in the mass layoff process. If unionization becomes unavoidable, companies are recommended to properly manage the union establishment process, to ensure that the union takes a cooperative attitude towards labor relations.

Highest Court in Shenzhen Issues New Guidance on Labor Disputes

The Shenzhen Intermediate People's Court issued its "Guidance on Dealing with Labor Dispute Cases" ("**Guidance**") in September and the full text was released in early December. The Guidance is based on earlier guidance issued by the Shenzhen Intermediate People's Court in 2009, and mainly clarifies the following issues:

- Non-compete: According to the Guidance, if there is any discrepancy between Shenzhen's non-compete rules and the Supreme People's Court's guiding interpretations, the Shenzhen local rules shall prevail. This means that although the Supreme People's Court's interpretation sets 30% of the employees' average monthly salary over the past 12 months ("**AMS**") as a reasonable rate of compensation, in Shenzhen, companies should still offer at least 50% of the AMS as monthly compensation in order to comply with Shenzhen's local rules.

- Open-term contract: The Guidance specifies that if an employee satisfies the conditions for signing an open-term employment contract, the employee should raise the request for an open-term contract before the expiration of the current fixed term contract.

- Unused annual leave compensation: If the employment contract, collective contract or the company's policies do not specify the compensation standard for the company's additional annual leave days, the compensation standard for statutory annual leave should apply to those additional annual leave days. In addition, the Guidance clarifies that if an employee wishes to claim for compensation for accrued but unused annual leave during the time of employment, the one year statute of limitations period for bringing such a claim will begin counting from January 1 of the third calendar year following when the annual leave originally accrued. If the employment relationship is terminated or expires, the limitation period should start to run from the last date of the employment.
- Hiring of non-PRC residents: If foreigners or Hong Kong/Macao/Taiwan residents are hired without a valid work permit or if they change employer without the details of the new employer being updated in the work permit, the employment relationship will be regarded as not having been established.
- Salary for the wrongful termination period: If an employee is wrongfully terminated by the employer and is reinstated by a labor arbitrator or a court, the salary standard for the period of wrongful termination should be the employee's average normal salary over the previous 12 months before the wrongful termination took place.

Key Take-Away Points:

Employers in Shenzhen should ensure that they comply with Shenzhen's non-compete compensation standard (50% rate) even though national standards may be lower. In addition, when hiring non-PRC residents, employers should be aware that inaccuracies in work permits may cause significant disruption for both employers and employees. Finally, companies should make clear distinctions in their company policies between statutory and additional annual leave if they wish to compensate additional annual leave at a lower rate.

National Holiday Arrangement Announced for 2016

The State Council announced the holiday schedule for 2016 ("**Notice**"), under which weekend and working days are switched in order to provide workers with a longer consecutive period of time off from work. Although the Notice is not compulsory for private companies (other than the days of official public holiday), it is common practice for employers in China to follow this arrangement as this is generally expected by employees.

Official Public Holiday	Adjusted Holiday Arrangement
New Year's Day (1 day)	Non-Working Days: January 1 - 3
Spring Festival (3 days)	Non-Working Days: February 7 - 13 Working Days: February 6 (Saturday), February 14 (Sunday)
Tomb-sweeping Day (1 day)	Non-Working Days: April 2 - 4 Working Days: April 5 (Tuesday)
Labor Day (1 day)	Non-Working Days: April 30 - May 2 Working Days: May 3 (Tuesday)
Dragon boat Festival (1 day)	Non-Working Days: June 9 - 11 Working Days: June 12 (Sunday)
Mid-Autumn Festival (1 day)	Non-Working Days: September 15 - 17 Working Days: September 18 (Sunday)
National Day (3 days)	Non-Working Days: October 1 - 7 Working Days: October 8 (Saturday), October 9 (Sunday)

Courts and Local Legislature Grapple with Discrimination Issues

The Beijing Shunyi District People's Court ruled in favor of a female graduate in a much reported employment sex discrimination case on October 30, 2015. The court awarded RMB 2,000 as compensation for emotional damages and RMB 6,570 for actual losses (such as fees incurred for various pre-employment procedures). However, the Court rejected the graduate's claim for a written apology. In this case, the female graduate applied for a courier position but was refused employment because of her gender (please refer to our **Newsletter of October 2015** for more details on this case).

The local authorities in Guangdong province are also considering how to provide more protection to female employees. Under draft regulations issued for public comment, female employees may be entitled to leave during their menstrual period, and increased maternity leave in certain

circumstances. In addition, companies may be required to provide female employees with one gynecological exam each year. It is unclear when these regulations will be passed.

While there has been some halting progress in providing more protection to female employees, the law still provides little to no protection against discrimination based on sexual orientation. In November 2015, the Shenzhen Intermediate People's Court ruled in favor of a company in the first sexual orientation discrimination case ever heard by the courts in China. The court held that the company had not infringed the personal dignity and right of equal treatment of a gay employee during the termination process. Previously, in February 2014, an employee sued a company in Beijing alleging discrimination on the basis of sexual orientation. However, the court refused to accept that case on the basis that it was an employment case and thus should have first been filed with the local employment dispute arbitration commission (please refer to our **Newsletter of February 2014** for more details).

In this recent case, an online video of the employee quarreling with another person was released and the footage disclosed the employee's sexual orientation. The company summarily dismissed the employee one month later on the basis that the employee had not complied with the company's uniform policy, and complaints about the employee having a bad attitude with a client had also been received. However, the employee believed he had been dismissed due to his sexual orientation. The employee had obtained an audio recording of the company's HR manager in which he said that "the employee's online video affects the company's image". The court dismissed the employee's claim for infringement of personal dignity and the right to equal employment because: (i) the audio recording was insufficient to prove that the termination was due to the employee's sexual orientation; and (ii) the employee indicated in his separation form that the reason for separation was due to his approach to work, which was irrelevant to sexual orientation.

Key Take-Away Points:

Under PRC law, discrimination against an employee or job candidate on the basis of race, ethnicity, sex, religion, pregnancy, marital status, disability, communicable disease carrier status, and migrant worker status is explicitly prohibited. The courts slowly seem to be becoming more willing to handle sex discrimination cases. However, there is no clear statutory protection against discrimination for employees or job candidates on other grounds seen in some other jurisdictions, such as sexual orientation or age. Despite this, the Shenzhen courts interestingly did not summarily dismiss the discrimination case brought by the gay employee, suggesting that some courts may be willing at least to hear discrimination cases even where there is no explicit statutory protection.

It is advisable in this changing environment for companies to adopt anti-discrimination policies and implement training programs to enhance the awareness of managers and employees on discrimination, to reduce exposure to claims for discrimination.

Terminations Ruled Unlawful Due to Procedural Defects in Employee Handbook Consultation Processes

In October 2015, the Beijing Tongzhou District Labor Arbitration Commission reportedly ordered a company to pay double severance to an employee who was terminated for failing to follow the leave application procedure.

The employee took marriage leave after only obtaining his former supervisor's verbal consent. The company took the view that his leave was an "unexcused absence" based on its employee handbook. The handbook stipulated that marriage leave applications must be submitted in writing 10 working days in advance and supporting documentation such as photocopies of certificates were required. The business department had to approve the request which then had to be verified by the Human Resources Department.

The labor arbitration commission found that although the employee had signed a document confirming receipt of the employee handbook, the company had failed to legally adopt it in accordance with the statutory democratic consultation procedures. Therefore, the termination was ruled unlawful.

In another recently reported case, the Shanghai Qingpu District People's Court also ruled that a termination based on an employee handbook was unlawful. The company in this case terminated an employee based on the grounds that his disobedient and threatening behaviour violated the latest version of their employee handbook. However, the court found that the employee had not received the latest version of the handbook and had only signed an earlier version. In addition, the company had also failed to submit sufficient evidence to prove the employee's misconduct. Therefore, the court awarded double severance for wrongful termination.

Key Take-Away Points:

These cases demonstrate the legal risks for employers to terminate employees based on company policies that have not gone through the full employee consultation process in accordance with the Employment Contract Law ("**ECL**"). If a company terminates an employee based on company policies, the termination could be ruled unlawful if the company policies are found to have not been legally adopted and hence are held invalid. In particular, while many courts in practice simply accept evidence that the handbook has been publicized to all employees, the Beijing case demonstrates that some courts will require that the full consultation procedure be followed.

Employee Termination for Misuse of Home-Visit Leave Upheld by Court

In a recent case decided by a Shanghai court, an employee applied for home-visit leave (*tanqinjia*) and the application was approved by the Company. However, the employee did not actually visit his family, and instead used the supposed home-visit leave to travel around Europe. The Company took the position that the employee's behaviour constituted "making false statements to the company" and "unjustified leave of absence" (*kuanggong*), which was defined as a "serious violation" of company rules in the company's employee handbook, and thus terminated the employee's employment in accordance with its employee handbook.

The employee argued that his behaviour was not inappropriate, and challenged the termination in a local labor arbitration tribunal, which found that the employee's behaviour did not constitute serious misconduct, and thus ruled in favour of the employee.

The company brought the case to court, and the court found that the employee's behaviour violated his duty of integrity to the company, and constituted an "unjustified leave of absence". On this basis, the court ruled that the termination conducted by the company in accordance with its employee handbook was lawful.

Key Take-Away Points:

In practice, employers often use the ground of "serious violation of company rules" to terminate employees. To ensure that the termination is accepted by the court as lawful, the employee's alleged misconduct should clearly fall within the definition of a "serious violation" in the employee handbook or standalone company policy. If an employer's employee handbook includes a list of types of misconduct that would be considered as "serious violations" and an employee's alleged misconduct falls into the list, and the handbook or company policy is adopted legally, then the likelihood of the termination being held lawful by a court, would be significantly increased.

Ex-CEO Reinstated to an Alternative Position After Successful Wrongful Termination Claim

On September 25, 2015, the Shanghai No. 2 Appellate People's Court issued a ruling to reinstate an employee's employment with a company, but not to his original position of CEO.

In this case, the employee was the Board-appointed CEO and had signed an open-term employment contract. The Board later removed him from the CEO position due to his failure to properly perform his reporting obligations in the annual report and other public filings required for a publicly listed company. These failings resulted in administrative penalties being imposed on the company. The company terminated the employee for serious violation of company policies. Such termination was

later found to be wrongful. One key issue in this case was whether the employee was entitled to have his employment reinstated, even if he could not be reinstated to his original CEO position, which required the Board's appointment.

Under the PRC Employment Contract Law ("**ECL**"), an employee who is found to be wrongfully terminated can claim either reinstatement of employment or double statutory severance. If reinstatement is found to be impossible by the labor arbitration commission or the court, the only possible remedy the employee can claim is the double severance. Reinstatement is often considered a worst-case scenario by employers, since they have to take the employee back and continue to pay salary until the employee's employment contract expires or is otherwise lawfully terminated, and make salary back-payments for the entire arbitration / litigation period.

The ECL does not specify in what circumstances reinstatement would be deemed impossible. According to a 2007 Shanghai High People's Court's Opinion, if the employee's position no longer exists, or circumstances show that the employment contract can no longer be performed, generally the Court should consider that reinstatement is not possible. In this case, the Court believed that the Board's decision to remove the employee from the unique CEO position did not preclude the company from finding an alternative position. The company had over 1,000 employees and could therefore place the employee in an alternative position which corresponded with the employee's capabilities and the company's business needs. The Court did not specify any positions or suggest where in the corporate structure the employee should be reinstated to.

The Court also ruled that a fair and reasonable salary standard for the back-payment of salary is the company's average monthly salary as opposed to the employee's actual monthly salary prior to the termination. This type of ruling where the court lowered the salary standard for the back-payment in a wrongful termination case is very rare. The Court might have taken into consideration the fact that the employee was likely to be reinstated to a subordinate position.

Key Take-Away Points:

Courts may broadly interpret the "reinstatement" remedy in a wrongful termination case to include reinstatement to a different position and potentially to a different salary level. This may make the reinstatement remedy easier to implement, since even when the employee's original position is eliminated or has been taken by someone else, it is still arguably possible to reinstate the employee to another position. In such case, it is unclear whether the employer has the additional burden to prove that it does not have another suitable position available to defend against the reinstatement claim.

Two Cases on Agreements Requiring Minimum Service Periods Have Different Outcomes

In the Haidian District People's Court's publication, *Ten Typical Labor Dispute Cases in 2015*, the court reported on a case where a senior manager signed a bonus agreement ("**Bonus Agreement**") with an employer, agreeing to work for the company for one year in exchange for a special bonus. The agreement also provided that if the manager resigned within this one-year period, the bonus had to be repaid in full to the company. The company paid the manager the bonus in accordance with the terms of the Bonus Agreement and when the manager resigned four months later, the company did not request repayment at that stage. After some time, the company issued a claim against the manager for repayment of the bonus.

The court ruled that the Bonus Agreement did not violate any mandatory rules, and since the manager failed to provide any evidence to prove the existence of any duress or fraud by the company during the time of signing, the Bonus Agreement was held to be valid and binding on both parties. Further, the court held that the bonus was expressly conditional upon the manager's continued service for a one-year term. Because the manager resigned from the company as proved by his own resignation letter, he had failed to meet the condition for the bonus, and therefore was not entitled to the payment. The court held that even though the company did not request repayment at the time the manager left the company, the company had not expressly waived its right to repayment. On this basis, the court ordered the manager to make a back payment of the net amount of the bonus to the company.

In another service term agreement case, however, the same court ruled in favor of the employee. In this case, the employee signed a letter of undertaking ("**Letter of Undertaking**") with the company, whereby the employee agreed to serve the company for three years in exchange for the company's sponsorship of his Beijing *hukou*. The Letter of Undertaking also provided that if the employee failed to serve such service term, he was required to compensate the company for the costs of his *hukou* application and pay the company liquidated damages. In the second year of his employment, the employee resigned from the company. The company refused to transfer out his *dang'an* (official personnel file), and the employee sued the company. The company then counter-sued the employee for liquidated damages as per the Letter of Undertaking.

During the court hearing, the employee confirmed the authenticity of the Letter of Undertaking, but argued that its terms were against the law and thus invalid. The court agreed with the employee's argument, and ruled that under the Employment Contract Law, employers are only allowed to impose liquidated damages on an employee for special training provided to the employee, or for the employee's violation of non-compete

restrictions, and any other liquidated damages agreement shall be deemed invalid.

Key Take-Away Points:

The law sets clear rules on situations where a liquidated damages agreement is allowed, as seen by the decision of the Haidian District People's court in the second reported case. Service term agreements in some special situations, however, could be held as valid in practice.

For example, the Shanghai High People's Court also gave the view in its 2009 official guiding opinion that if an employer provides certain special benefits of relatively high value (such as a car, apartment or housing allowance) conditional upon the employee's agreement to a specific service term, any such payments made should be treated as an advance payment, and the employer may request a *pro rata* refund if the employee fails to fulfil the service term.

Companies should carefully structure and document their service term agreements to increase the possibility of its enforcement based on laws, regulations, and local practice.

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