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# China Employment Law Update - August 2014

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## **Comments**

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# China Employment Law Update

People's Republic of China

BAKER & MCKENZIE

August 2014

## Significant Recent Developments in China's Household Permit System

On July 30, the State Council promulgated the *Guidelines on Further Promoting Household Permit System Reform* ("**Household Permit Guidelines**"), which marks a major breakthrough in China's efforts to reform the household permit (*hukou*) system and may lead to a more mobile and flexible workforce.

Based on the Household Permit Guidelines, China aims to establish a new, unified household permit system that no longer classifies citizens as rural or urban household permit holders. The state's policy goal is that by the year 2020, approximately 100 million rural and other migrants will obtain household permits in the city where they live.

The Household Permit Guidelines divide cities in China into four types based on the city population, and provide for different household permit policies accordingly, with smaller towns and cities eliminating or significantly reducing the restrictions on obtaining a local household permit. In megacities with more than five million residents (such as Beijing and Shanghai), a points system should be established whereby if certain conditions are met regarding years of continuous residency and social insurance, a person may qualify for a local household permit (some cities, like Beijing, currently have no such points system and make it very difficult for outsiders to ever qualify).

The Household Permit Guidelines also provides for a new residency permit system under which when a citizen leaves his/her official hometown to reside in a municipality for half a year or more, the citizen will need to obtain a local residency permit, based on which the citizen will be eligible for certain benefits that a local household permit holder would be entitled to such as basic public education for children, basic medical services, family planning services, etc. In addition, based on other conditions such as one's continuous years of local residency and years of social insurance contributions, the individual may also be eligible for vocational educational subsidies, employment assistance, housing benefits, old-age care, and other local social benefits.

To achieve the goals set out in the Household Permit Guidelines, the Household Permit Guidelines call on various government ministries to

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promulgate specific implementing rules to address with more specificity the points discussed above. It remains to be seen when and how the implementing rules will be promulgated and implemented.

In a related development, a law school graduate from Anhui province brought a household permit discrimination lawsuit against the Human Resources Service Center of Gulou District in Nanjing City; according to local media, this was the first case of its kind brought in the PRC. The case ultimately settled so it is unclear how the courts would have ruled on the case. However, the case does show that job applicants' awareness of anti-discrimination principles is increasing and that they are willing to bring legal action for alleged violations in this area.

## Supreme People's Court Provides Guidance on Work Injury Cases

On June 18, 2014, the PRC Supreme People's Court issued the *Provisions on Various Issues Regarding the Handling of Work Injury Administrative Lawsuits* ("**Work Injury Interpretation**"), which will take effect on September 1, 2014. The Work Injury Interpretation provides more specific guidance on the circumstances in which an injury suffered by an employee shall be considered as a work injury, how to allocate liabilities in cases involving multiple parties, and on other issues.

The Work Injury Interpretation expands upon existing regulations regarding the scope of injuries that may be considered work injuries: For example, injuries occurring during social events organized by a company would be considered a work injury. Furthermore, while existing regulations already state that injuries occurring during commutes to and from work would be considered a work injury, the Work Injury Interpretation makes clear that even if an employee takes an indirect route back home, for example to take care of necessary errands like shopping for groceries, injuries that occur during reasonable stops on the way back home can be considered work injuries.

Furthermore, the Work Injury Interpretation also provides guidance on who will assume liabilities for the employee's work injury in situations involving multiple parties. For example, if an employee has two or more employers and suffers a work injury, the employer for whom the employee was actually working when the injury took place shall assume the work injury liabilities to the employee. More significantly, if a dispatched worker suffers a work injury while working for his/her host company, the labor agency that employs and dispatches the injured worker shall assume work injury liabilities to the dispatched worker.

## Highest Court in Guangzhou Issues New Guidance on Employment Disputes

In May 2014, the Guangzhou Intermediate People's Court, which is the highest court in Guangzhou, issued the *Guangzhou Meeting Minutes on Various Issues in the Trial of Employment Disputes* ("**Guangzhou Meeting Minutes**"), which provides clarification on some controversial employment issues often faced by employers, such as those related to non-compete compensation, waiver and release of claims, and open-term contracts for dispatched employees.

For example, the Guangzhou Meeting Minutes provide that if the non-compete agreement is silent on the non-compete compensation, the employee may decide whether to perform the non-compete obligations, which essentially means the company no longer can force the employee to abide by the non-compete restriction.

In addition, the employer may reach an agreement with the employee and pay the non-compete compensation in a lump-sum after the termination of employment; current law provides that non-compete compensation should be paid in monthly installments during the post-termination non-compete period. Furthermore, in non-compete disputes, the court would not issue an injunctive order for the competitor to cease employment with the employee who violates the non-compete obligations. Rather, it may order the employee to continue performing his non-compete obligations in accordance with the non-compete agreement.

The Guangzhou Meeting Minutes also provide guidance regarding how to handle employee claims after they signed waiver and release agreements. According to the Guangzhou Meeting Minutes, the court should consider whether the employee's claims have been specifically waived in the agreement. If so, the release agreement should be enforceable and will be honored.

The Guangzhou Meeting Minutes also make clear that the rules granting employees a right to an open-term contract in certain circumstances also apply to dispatched employees. Currently, the national law is silent on this issue, and courts in other localities (e.g. Jiangsu province) have taken the opposite view on this issue.

Furthermore, the Guangzhou Meeting Minutes state that unused annual leave compensation should be included as part of the base amount for calculating severance. It is not entirely clear whether the unused annual leave compensation referred to herein is meant to cover annual leave compensation paid out upon termination of employment, or only

compensation that was previously paid during the last 12 months of employment (i.e. for unused annual leave that was paid out at the end of the prior calendar year).

Finally, according to the Guangzhou Meeting Minutes, any contractual agreement on the forum for any employment dispute would not be recognized by the courts. Currently, under national law, courts in the location where the employer is registered, or where the employment contract is performed, can exercise jurisdiction over employment-related claims, though the place of performance would take priority. National law is not clear on whether the parties can agree to choose the jurisdiction of a specific court through agreement, but the Guangzhou Meeting Minutes expressly prohibit the parties from doing so.

## Sino-Danish Agreement on Social Insurance Exemptions Comes into Force

On April 1, 2014, the General Office of the Ministry of Human Resources and Social Security issued a notice to implement the Agreement on Social Security between the People's Republic of China and the Kingdom of Denmark, which came into force on May 14, 2014 ("**Social Security Agreement**").

According to the Social Security Agreement, Danish employees who are employed by a Danish employer and then seconded to China to work for less than three years can be exempted from making pension insurance contributions in China, and Chinese employees who are employed by a Chinese employer and then seconded to Denmark to work for less than five years can be exempted from making social pension contributions and labor market supplementary pension (Arbejdmarkedets Tillaegs Pension, "**ATP**") contributions in Denmark. While the Social Security Agreement is silent on whether Danish citizens locally hired in China may also qualify for the exemption, in practice if proof of participation in Denmark's pension system is provided, such employee may also be able to avoid making pension contributions in China depending on the position of local authorities. However, Danish employees working in China will still need to be enrolled in the other four types of social insurance provided by China's social insurance system.

This exemption will slightly alleviate the burden on employees seconded from Denmark and the host entities where they work. Before the conclusion of this agreement, China also signed similar social insurance exemption agreements with South Korea and Germany respectively.

## Shanghai and Suzhou Issue Measures to Enforce Labor Dispatch Rules

Following the (national) *Provisional Regulations on Labor Dispatch* of March 1, 2014 (“**Labor Dispatch Regulations**”), a number of cities and provinces have issued their own measures on the enforcement of the Labor Dispatch Regulations. On June 30 and July 7, 2014 respectively, the Shanghai labor authorities issued two separate measures regarding enforcement of the national labor dispatch rules. Among the specific items contained in those measures, Shanghai has set a deadline of October 31, 2014, for companies that use labor dispatch employees in excess of 10% of their workforce to file a “workforce adjustment plan” with the labor authorities. Similar to Beijing, the Shanghai labor authorities will issue an acknowledgement of receipt upon submission. Shanghai also requires companies to provide a specific timeline for how they will reduce their use of labor dispatch as part of the workforce adjustment plan.

In addition, Shanghai labor authorities have specified that companies which fail to follow the “equal pay for equal work” principle for labor dispatch workers, or that fail to follow the mandatory “employee consultation” procedure to determine which job positions will qualify as “auxiliary position” (one of the only three positions for which labor dispatch can be used) may face administrative penalties, if such issues exist and are not timely corrected. Companies that have not followed the relevant rules should consider correcting their practices soon to avoid penalties.

On July 14, 2014, the Suzhou labor authorities (in Jiangsu Province) have also issued their own measures related to workforce adjustment plans, which set an early deadline of August 31, 2014, for company submissions. The measures require detailed information to be included in the plan such as information on the current use of labor dispatch, detailed measures to reduce the use of labor dispatch, step plans, monthly implementation arrangements, and expected issues and solutions, etc. These requirements seem more detailed than the workforce adjustment plan requirements in most other major cities. In addition, the measures state that “disguised” labor dispatch through outsourcing arrangements is prohibited. Therefore, if the company includes outsourcing as one of the measures it will take to reduce labor dispatch, the authorities may closely scrutinize such arrangement or request more information.

Similar to other cities, both Shanghai and Suzhou have not specified penalties or other consequences for not submitting a workforce adjustment plan by the stipulated deadline. Therefore, it remains to be seen how strictly the local labor authorities will enforce these rules.

## Court Accepts Employee Claim to Invalidate Approval for Flexible Working Hours System

The Zhengzhou Intermediate People's Court in June 2014 reportedly ruled in favor of a former head of a supermarket food department to invalidate a labour bureau's approval of a company's application to adopt the flexible working hours system, overturning the lower court's judgement.

In the case, an employee sued the local labour bureau because it granted a flexible working hours approval to his former employer, a supermarket, which thereby refused to pay the employee any overtime compensation. The employee claimed that the approval was illegal due to the nature of his job (which requires him to sign up on time and work for 10.5 hours everyday) and because the application and approval process did not meet local regulatory requirements.

The first instance court ruled against the employee, judging that the labour bureau had the right to issue the approval. The second instance court overturned the lower court's judgment mainly on procedural grounds, in that: (i) the documents submitted to support the approval were inadequate since no resolution of an all-employee meeting was found; and (ii) there was no evidence that at least two officials had carried out onsite inspection of the supermarket as required by local regulations.

The case shows that even if a company has obtained approval from the local labor bureau to implement the flexible working hours system, there is still the possibility that employees may challenge the validity of such approval, though such cases are still rare.

## General Manager Successfully Challenges Termination Even after Being Removed by Board of Directors

As reported on August 8, 2014, the Shanghai Hongkou Arbitration Committee ruled that a company illegally terminated its general manager and ordered the company to reinstate him, even though the company's board of directors had removed him from the post of general manager in accordance with the Company Law.

The company's board of directors decided to remove the general manager on May 13, 2014 and the proposal to remove the general manager from the board of directors was passed at a shareholders' meeting on June 12,

2014. The employee's employment was deemed by the company to have been terminated as a result.

According to the company, the grounds for termination of employment were dereliction of duty and serious violation of company rules. Specifically, the company introduced an audit report prepared by a professional accounting firm as the justification for the termination of the employee. The audit report cited material defects in the company's internal control system and gave an adverse opinion on the system. The company claimed that the employee as general manager was solely responsible for establishing and implementing the internal control system and therefore was responsible for the defects in the system.

The arbitration decision found that: (1) a general manager cannot be held solely responsible for a corporate internal control system or the damages caused by its defects because the board of directors, chairman of the board, and other senior managers are also responsible persons for the internal control system; (2) the company had not provided sufficient evidence to prove that the employee acted negligently or improperly in performing his duties associated with the internal control system (in fact, the evidence supported the opposite conclusion because the board of directors had evaluated the employee's performance and rated it as being "up to grade" as recently as January 2014); and (3) the company had not provided sufficient evidence to prove that the defects in the internal control system caused significant damage to the company. The arbitration decision therefore ruled that the termination was illegal and granted the employee reinstatement and payment of salary for the period from termination until reinstatement.

As a final point, the arbitration decision emphasized that while the removal of an employee from the position of general manager is completely discretionary and can be done in accordance with the Company Law and the company's articles of association, the removal will not and cannot automatically result in termination of employment. Termination of employment is restricted by the Employment Contract Law and only may occur if its requirements are met. It should be noted that this was only an arbitration ruling, and some courts in Shanghai may take the position that removal of a general manager by the board of directors may provide grounds for termination.

## Employee's Claim for Revoking Voluntary Resignation Rejected by Court

A local court in Dongguan reportedly rejected an employee's claim for revoking his voluntary resignation. The employee reportedly signed a statement of voluntary resignation presented to him by the company

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after he was caught by the company stealing company property. However, the employee later challenged the validity of the voluntary resignation on the grounds that he did not read through the statement of voluntary resignation. The employee thus sued the company for payment of compensation for wrongful termination and unpaid overtime payment, which equalled approximately RMB 150,000 in total. Viewing the employee as an adult who is able to read, the court reportedly held the voluntary resignation enforceable and rejected the employee's claim for payment of wrongful termination compensation. However, the court found that the employee had worked overtime extensively and had not taken annual leave during his long years of service with the company. The court therefore ordered the company to pay to the employee compensation in the amount of almost RMB 10,000.

This case shows that normally it would be difficult for an employee to revoke a resignation letter or other termination agreement as long as it has been properly signed and there is no direct proof of coercion.

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