

NEWSLETTER

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This newsletter gives a brief instruction on the **New Labour Law** which will be effective on January 1st, 2008.

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Practical Effects of the New Labour Contract Law Of the People's Republic of China

The New Labour Contract Law of the People's Republic of China (hereinafter the "**New Labour Contract Law**" or "**NLCL**") will take effect on January 1st, 2008. The significance of the new law rests in its new standards for labor contracts, trade unions, dismissal conditions, and severance pay. We introduce in this newsletter the most influential components of the New Labour Contract Law.

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Probation Period

Article 19 of the NLCL addresses the maximum probation period that can be assigned by an employer according to the employment contract term. If an employment contract term is less than 3 months, no probation period can be specified. If the contract term is more than 3 months but less than 1 year, the probation period cannot exceed 1 month. If the contract term

is more than 1 year and less than 3 years, the probation period cannot exceed 2 months. If the contract term is no less than 3 years or is open-ended, the probation period may not exceed six months. An employer may agree to only one probation period with any given employee.

Prior laws concerning the maximum probation period differ from the NLCL in the time frames used. That is, instead of specifying the contract term by periods of 3 months, 1 year, and 3 years, the old laws use terms of 6 months, 1 year, and 2 years with probation periods of 15, 30, and 60 days, respectively. The chart below highlights these differences.

Comparison of the Labour Law (1995) and the New Labour Contract Law (2008)

The Labour Law of PRC executed in January 1st, 1995 and its administrative interpretation		The Labour Contract Law executed in January 1st, 2008	
Contract term	Probation period	Contract term	Probation period
Less than 6 months	No more than 15 days	Less than 3 months	No probation period
6 months – 1 year	No more than 30 days	3 months – 1 year	No more than 1 month
1 – 2 year	No more than 60 days	1 – 3 year	No more than 2 months
More than 2 years	No more than 6 months	3 years – open ended	No more than 6 months

Summary: The New Labor Contract Law sets a new standard for probation periods. Companies will be expected to execute the probation period pursuant to the New Labor Contract Law and will be expected to not stipulate any probation period longer than the legal probation period.

Internal Labour Rules

According to Article 4 of the NLCL, the internal labour rules must be made known to the employees before it can become effective. If the rules directly influence employee interests, such as those concerning compensation, work hours, vacation, leave, work safety and hygiene, insurance, benefits, employee training, work discipline or work quota management, the rules shall be discussed by the trade union, by all the employees together, or by the employees' representative. Furthermore, the trade union or employees may require the employer to revise any improper internal labour rules.

Case:

A company sets up a disciplinary policy, regulating that all employees shall go to work at 8 am, and shall otherwise be fined RMB 50 for each breach. Employees are informed of the new rule, but it is not endorsed by the trade union or any employee. The rule could therefore be regarded as invalid if or when conflict occurs.

Summary: To some extent this is a new provision on internal policies. Although old statutes provide that the internal policy shall be set out through "democratic procedures" and shall be "made known to the public", the New Labour Contract Law provides greater detail on how internal labour policies can become effective and valid.

Trade Unions

The New Labor Contract Law does not affect trade unions. Consequently, trade unions will continue to be regulated by the Trade Union Law (2001) which states that setting up a trade union is the right of the employees, but not the obligation of the employer. So, if the employees do not wish to set up a trade union, the company will not be punished for not having one. If a trade union is created, the employer must provide financial support amounting to 2 percent of the total workers' salary, and cannot interfere with its operation.

Case:

Company A has no labour union. The company has 10 workers, whose total income amounts to RMB 30,000 per month. One day its employees decide to set up a union. Although Company A employers are opposed to it, they cannot stop the establishment of the union. After the Union is set up, Company A is required by the Trade Union Law (2001) to pay operational fees amounting to 2% of the workers' total salaries, i.e., RMB 600 per month, to support the union.

Summary: The New Labour Contract Law does not affect trade unions, which will continue to be regulated under the Trade Union Law of 2001.

Collective Contracts

According to Articles 51-56 of the New Labour Contract Law, a collective contract can either be signed between the employer and all the employees or between the employer and the trade union. The collective contract must be concluded, however, by the trade union. If there is no trade union in the company, it must be concluded under the guidance of the trade union at the next higher level such as at the city or provincial trade union level. The salary and working condition standards stipulated in a collective contract cannot be lower than the minimum rates and standards prescribed by the local government.

After a collective contract has been concluded, it must be submitted to the Labour Bureau. The contract becomes effective if unopposed by the Labour Bureau within fifteen (15) days upon receipt.

Case:

Company A has signed a collective contract with the employee trade union. Both parties agreed to a minimum salary standard of RMB 800. The collective contract was brought to the local Labour Bureau for approval. After fifteen (15) working days, there was no news from the Labour Bureau, so the collective contract became effective by default.

Later, the company signed an employment agreement with Tom, a new employee, and set Tom's salary at RMB 600. Because Tom's contract violates the terms of the collective contract's minimum salary standard, Tom's salary agreement is invalid.

Summary: The provisions for collective contracts are not new. Actually, the previous statutes contain the same provisions as the New Labour Contract Law (2007).

Training Fees

According to Article 22 of the NLCL, if an employer pays employees for training programs, he may also require the employee to sign an agreement specifying a term of service. If the employee breaches the service term agreement, he must pay liquidated damages to the employer for the training fees in proportion to the amount of service completed.

Case:

Company A pays RMB 10,000 to an employee, Jim, for an English language course. Before the payment is made, both parties signed a contract stating that Jim would not resign within one (1) year thereafter. Six months later, Jim decided to quit his job. In this case, he must pay Company A a compensation amounting to half of the course tuition fees, i.e., RMB 5,000, because he completed only half of his stipulated service term.

Summary: The New Labour Contract Law enacts two important changes from prior statutes by stipulating that: 1) remuneration is specified as being proportional to the amount of service completed, and 2) the company has the right to conclude a service agreement with an employee before providing training. Article 22 of the NLCL, then, favors the company when service term agreements are breached.

Trade Secrets and Non-Competition Provisions

According to the New Labour Contract Law, an employer and an employee may include in their employment contract provisions for confidentiality and competition restriction concerns.

The previous labour law had stipulated that contracts can include clauses on confidentiality, but it did not mention competition restriction terms.

In order to ensure that these confidentiality and competition restriction provisions are promissory, the following items have been clarified by the New Labour Contract Law:

1. *Scope of personnel subject to the competition restriction provisions:* The personnel subject to competition restrictions must be limited to the employer's senior management, senior technicians and other personnel bound by a confidentiality obligation.
2. *Term of competition restriction:* The competition restriction term cannot exceed two years from the date when the employment contract was terminated.
3. *Scope of the competition restriction:* During the competition restriction term, an employee is not allowed to work for a competing company or attempt to establish his own company that produces the same type of products or is engaged in the same type of business as his former employer.
4. *Method of payment for financial compensation:* An employer must pay financial compensation to the employee on a monthly basis during the competition restriction term after the termination of the employment contract.
5. *Sum of financial compensation:* Neither the old labour law nor the New Labour Contract Law set a standard for financial compensation fees. While the employer and employee can stipulate the sum of financial compensation in the labour contract, there are many local regulations that will specify a standard sum for financial compensation. The sum in different regions can range from 1/2 to 2/3 of the employee's total income over the last full year. Financial compensation can therefore be regulated at the local level.

Case:

John is a sales manager for Company A. Company A and John enter into a labour contract that includes trade secret and competition restriction provisions. When the labour contract expires, John leaves Company A. Company A does not pay financial compensation to John despite its obligation to do so according to the employment contract. Within the competition restriction term (2 years), John accepts an offer from Company B (a rival of Company A) to work as a sales manager.

Company A consequently files damages against John, demanding that he stops working for the rival company. Because Company A breached the competition restriction provisions first by not paying financial compensation, John was not bound by those provisions when he accepted work with Company B and he can therefore continue to work for Company B. John may not, however, disclose any of Company A's trade secrets because his confidentiality obligation remains valid whether or not Company A paid him the stipulated financial compensation.

Summary: The New Labour Contract Law defines many details of competition restriction provisions, including the scope of personnel subject to the competition restriction provisions, the term and scope of competition restriction, and the method of payment for financial compensation.

Employment Agencies

According to New Labour Contract Law, labour agencies will continue to exist and abide by the following regulations:

1. *Minimum Registered Capital:* Employment Agencies will be established in accordance with the relevant provisions of the Company Law. These firms must have a registered capital of no less than RMB ¥ 500,000, which differs from the amount stated in the Company Law.

2. *Labour Agencies as Employers:* Employment Agencies are employers and must perform employer obligations toward its employees. The employment contract between an Employment Agency and an employee must be in accordance with the general employment contract and must specify employment conditions such as the company with which the employee will be placed, the term of his placement, his position, and so on.
3. *Employment Term and Compensation:* The employment contracts between Employment Agencies and the employees to be placed shall be fixed-term employment contracts for no less than two (2) years. During periods where there is no available work for employees, the Employment Agency must provide them with monthly compensation at the minimum wage rate prescribed by the People's Government for the Employment Agency's location.
4. *Accepting Company Contracts:* When placing employees, Employment Agencies shall enter into agreements with the companies that accept the employees. These companies are called "Accepting Companies" and will stipulate with the Employment Agencies: 1) the job positions into which employees are to be placed; 2) the number of persons to be placed; 3) the placement terms, 4) the amount and methods of payment for labour compensation and social insurance premiums; and 5) the liability in the event that the agreement is breached. An Accepting Companies must decide with the Employment Agency the placement term based on the actual requirements of the job position. For example, it is not acceptable for an Accepting Company to use several short-term placement agreements to cover a continuous term of labour.
5. *Transparency and Cost of Services:* Employment Agencies must inform placed employees of the content of the placement agreement. Employment Agencies cannot receive or request a part of the labour compensation that the Accepting Companies might pay to the employees according to the placement agreement. The Employment Agencies can charge fees from Accepting Companies, but neither Employment Agencies nor Accepting Companies can charge fees from the employee.
6. *Location-based Standards:* If an Employment Agency places an employee with an

Accepting Company in another region, the Employee's labour compensation and working conditions are determined by the rates and standards of the Accepting Company's location.

7. *Internal placement is not allowed:* Employers may not establish Employment Agencies to place employees with themselves or their subordinate units.

Case:

A representative office of a foreign company (the "RO") wants to hire a Chinese employee named Rose. What should the company do?

According to Chinese law, the RO has no right to hire Rose directly. Instead, it has to enter into an agreement with a Employment Agency. The agreements stipulate Rose's position, the placement term, the conditions of payment for Rose's labour compensation and social insurance premiums, and the liability in the event of a breach of contract.

Rose, in turn, must enter into a labour contract with the Employment Agency. The Employment Agency is the real employer from a legal perspective. The Employment Agency places Rose with the RO, and the labour contract signed between Rose and the Employment Agency has a term of at least two years. The Employment Agency will have to pay labour compensation and social insurance for Rose on a monthly basis. If the RO (the Company Unit) fails to provide a position to Rose during the term of the labour contract, it is the Employment Agency's responsibility to pay labour compensation to Rose. This compensation depends on the minimum wage rate prescribed by the People's Government for the location of the Employment Agency.

Summary: The New Labour Contract Law clarifies the relationships among and between the Employment Agencies, Accepting Companies and employee. Between the Employment Agencies and the employee, the relationship is the same as that between an *employer* and an employee. The Employment Agencies and the employee sign a fixed-term employment contract for a term of no less than two years. Between the Employment Agencies and the

Accepting Company, the relationship is that of one business to another, with the Employment Agencies acting on behalf of the employee. The Employment Agencies and the Accepting Company sign a normal business contract that stipulates the working conditions for the employee.

Labour Relations in Merger and Acquisition Cases

In M&A scenarios, the existing employment contracts remain valid and continue to be performed by the employer(s) that assume(s) those rights and obligations. Usually, existing labour relations will simply continue between the employee and the former employer's successor.

Under Article 40 of the New Labour Contract Law, however, a merger and/or acquisition constitutes a "major change" in the operations of a company. A major change allows the purchaser some leniency in continuing the obligations of the former employer towards the employees. If the purchaser decides to continue the existing labour contract, the title of the employer is the only part of the contract that needs to change in an M&A scenario.

If the purchaser does not wish to continue the existing labour contracts, they are allowed to terminate a previous contract if 1) circumstances that were present at the conclusion of the original contract are no longer present after the M&A and the new employer cannot perform the previous employer obligations; and 2) negotiations between the company and the employee have failed to render an acceptable, revised contract. Under these circumstances, the purchaser must provide either 30-days notice or a month's wage in lieu of a written notice to an employee in order to legally terminate their contract.

If the purchaser wishes to continue an existing contract, but the employee does not, he can terminate his contract by giving a 30-day' written notice to the new employer(s). An employee that terminates his contract in this way waives his right to claim severance fees.

Case:

Jack enters into an employment contract with Company B and works as an employee for several years. When Company B is merged by Company C, how will the labour relations change between Company B, Company C, and Jack?

Usually, Company C will decide to perform the employer's obligations under the existing employment contract between Company B and Jack. There are, however, several options for Company C and Jack, as follows:

- 1. If Company C and Jack agree on all provisions included in the existing contract, they only need to modify the employer's name in the existing employment contract, changing it from Company B to Company C.*
- 2. If Company C does not want to continue using the existing contract and no amended contract can be successfully negotiated, Company C can terminate the existing contract by paying severance fees to Jack. [For more information on severance fees, see the Severance Fees and Economic Layoff section below.] Termination of the contract in this manner must be accompanied by 30-days notice or an additional payment of one month's wages to Jack.*
- 3. If Jack does not want to continue the existing contract, he can terminate it by giving Company C 30-days written notice, but he will not be entitled to receive severance pay from Company C.*

Summary: In M&A cases, the existing employment contracts continue to be performed by the new employer who assumes those rights and obligations. However, as M&A is considered a "major change" in contract, the employer can terminate the labour contract by paying employee severance fees.

Severance Pay and Economic Layoff

Pursuant to Article 47 of the New Labour Contract Law, if a company chooses to terminate a contract with their employee, the employee must be paid severance fees as financial compensation. These fees are determined by the number of full years worked for the company by the employee. The longest working period that can be used to calculate the Financial Compensation Fee is 12 years.

The New Labour Contract Law sets severance fees at one month's wages for each full year worked.* A period of more than six months, but less than one year, is counted as a full year. Contrary to previous regulations, if an employee has worked for a company for less than six months, they are entitled to one-half of one month's wages as financial compensation. The "monthly wage" is defined as the employee's average monthly wage for the twelve (12) months prior to the termination of their contract.

* If the employee's monthly wage is greater than three times the average monthly wage of other employees in their municipal area (as published by the People's Government), the severance pay is calculated using three times the average employee wage, rather than his actual monthly wage.

Case:

An employee named Jack works with a Guangzhou company for seven months, and his monthly salary is RMB 12,000. His employer now wishes to fire him, leading to two possible situations:

- 1. The employer issues a written notice to Jack thirty (30) days in advance. Because Jack worked for more than six months, his employment term is rounded up and calculated as one year, entitling him to one month's salary in severance pay. Furthermore, because the average monthly salary of employees in Guangzhou is RMB 3,027, the employer only has to pay Jack three times the average salary (a total of RMB 9,081) for one "full year" of*

work because Jack's monthly salary of RMB 12,000 is more than three times this average.

- 2. If the employer fires Jack without a written notice thirty (30) days in advance, the employer must pay Jack an additional one month's salary in lieu of the notice. In total, the employer will have to pay Jack a total of RMB 21,081, for RMB 12,000 (one month's salary in lieu of notice) and RMB 9,081 (three times the average salary as severance pay).*

Summary: Compared with the old regulations of severance pay, the New Labor Contract Law defines the maximum monthly wage that can be used when calculating severance pay.

Severance Pay and Termination of Labour Contracts

Pursuant to Article 41.1 and Article 46.5, if the employer does not wish to renew the labour contract with the employee at the end of the employment term, the employer must provide the employee with severance pay.

Case:

Jack's two years' labour contract will expire on August 31st, 2007. The employer will not renew the labour contract with Jack. Therefore, the employer pays Jack two months' salary (for two years' work) as the severance pay. On the other hand, if Jack chooses not to renew his contract under the same or better conditions as those stipulated in the previous contract, then his employer is not required to extend severance pay once the contract expires.

Summary: The New Labor Contract Law differs from previous laws by requiring severance pay upon the termination of a labour contract by an employer (there are no such requirements in prior statutes).

Part-time Labour

Pursuant to Article 68 of the New Labour Contract Law, *part-time labour* is defined as “a form of labour for which the compensation is chiefly calculated by the hour and where the

Employee generally averages no more than 4 hours of work per day and no more than an aggregate 24 hours of work per week for the same Employer.”

The following are special articles for part-time labour:

1. The two parties may (but are not required to) make an oral agreement;
2. The two parties are not allowed to stipulate a probation period;
3. Either of the two parties can terminate the agreement by providing notice to the other party at any time. No severance pay will be required of the employer upon terminating the use of the employee's labour;
4. The hourly wage for part-time labour cannot be lower than the minimum hourly wage rate prescribed by the People's Government for the employer's location. The labour compensation settlement and payment period for part-time labour must not exceed 15 days.

Case:

A Guangzhou enterprise hires a part-time employee named Susan to clean the office. The company concludes an oral agreement with Susan, but they are not allowed to stipulate a probation period. In Guangzhou, the minimum hourly wage is RMB 7.5 per hour for part-time employment, thus Susan's hourly wage must not be lower than RMB 7.5 per hour. If the company fires Susan at any time, the company can do so by providing notice and will not have to pay any severance pay.

Summary: These provisions are the first among previous labour laws to state a clear definition of *Part-Time Labour* and set related part-time labour standards, such as the minimum allowable wage and payment period.

New Labour Contract Law Summary

The New Labor Contract Law is presently becoming well-known throughout the country and the authorities will strictly supervise the execution of the New Labor Contract Law starting January 1st, 2008. Generally speaking, the New Labor Contract Law has more thorough restrictions on labour contracts that will better protect workers' rights and simultaneously place the heavier burden of providing these rights on the enterprises located within the PRC.