



One Firm WorldwideSM



THE CHINESE EMPLOYMENT CONTRACT LAW OF 2007

Samuel Estreicher, Michael J. Gray, and Winston Zhao

On Friday, June 29, 2007, the National People's Congress ("NPC") completed a two-year process culminating in the passage of a new Law on Employment Contracts.¹ The new law takes effect on January 1, 2008.

THE LEGISLATIVE PROCESS

The legislative process was characterized by an unusual degree of openness. The bill was first formally introduced in March 2006 when the Standing Commit-

tee of the NPC decided to circulate the draft for public comment, a first for a major national law.² During the one-month comment period, the draftsmen received more than 191,800 separate comments via the internet, newspapers, periodicals, and letters.³

The comment period proved to be quite useful to the lawmakers, influencing the content of the new law, especially the provisions concerning noncompete clauses, probation periods, the role of trade unions, severance payments, and layoffs.⁴ The sheer volume of comments did delay the date of adoption of the

¹ Law of the People's Republic of China on Employment Contracts (28th Session of the Standing Committee of the 10th National People's Congress, June 29, 2007, eff. Jan. 1, 2008). The new law, also referred to as the "Labor Contract Law," is hereafter denoted as "ECL."

² The initial draft of the law first appeared in public in December 2005, followed by drafts in March 2006 and December 2006.

³ Report of the Law Committee of the National People's Congress on Revisions to the Employment Contract Law (Dec. 24, 2006), p. 1.

⁴ U.S.-China Business Council, Comparison of Different Drafts of the PRC Labor Contract Law (Jan. 2007).

law, which went to an unusual fourth reading in the NPC. Its adoption in late June 2007 was nevertheless unexpected and may have been influenced by recent public reports of alleged use of slave labor in brick kilns and small coal mines in Shanxi and Henan Provinces. Indeed, the new law specifically addresses such concerns by establishing sanctions for corrupt officials who fail to enforce occupational safety laws.⁵

THE INITIAL FIE REACTION

Since the bill was first introduced in 2006, foreign investment enterprises (“FIEs”), including many multinational companies, have spent considerable time and effort commenting on the legislation and in some cases openly opposing it. Since the country opened its doors to investors in 1979, the number of FIEs in China has grown to more than 570,000, employing more than 25 million Chinese workers, principally in the major cities along the coast of China. Organizations such as the American Chamber of Commerce in Shanghai and the U.S.-China Business Council submitted detailed comments on the draft law, many of which ultimately improved the legislation.

Many of the provisions appearing in the new Employment Contract Law, including those relating to trade unions, already appeared in substance in China’s Labor Law of 1995.⁶ As a practical matter, however, these provisions were rarely enforced against the FIEs. Such major multinational investors in China have by and large been exemplary employers, importing their foreign labor practices and generally treating Chinese workers in a manner comparable to their counterparts in the U.S. or Europe. There was therefore little need for the local labor bureaus to be concerned with the labor practices of major multinational companies.

OVERALL DESIGN OF THE LEGISLATION

Although an employment relationship can be created without a contract,⁷ the new law requires that all workers ultimately receive a written employment contract.⁸ The penalty for the employer’s failure to provide a written contract after a year of employment is that the relationship becomes one of indefinite employment, which is considerably harder to terminate.⁹ Both the individual employee and union representative, if any, will be able to enforce the law’s provisions in the labor tribunals, specially created dispute-settlement bodies existing in all parts of China to handle employment matters. Workers can terminate the employment relationship on 30 days’ notice for any reason, but may also do so without notice if the employer fails to provide working conditions specified in the labor contract, does not pay wages or social insurance premiums on time and in full, or issues rules and regulations that violate the law.¹⁰

The ability of employers to terminate employment contracts is a bit more complicated. If the employment contract is for a fixed term, there would appear to be no obligation on the employer’s part to renew the agreement. The new law allows, however, only two such renewals, after which the employment relationship becomes one for indefinite employment.¹¹ Once the parties have entered into an indefinite-term relationship, termination of the contract requires a form of cause, such as material breach of the employer’s rules, a serious dereliction of duty, incompetence, disability, or a major change in objective circumstances rendering the contract unperformable.¹²

Because multinational FIEs typically do not commit the type of labor violations that are most common in China, it is unlikely that, at least initially, the law will alter significantly any of the labor practices of large foreign-based employers

5 ECL, Art. 95.

6 The Labor Law of the People’s Republic of China (Standing Committee of the National People’s Congress, July 5, 1994, eff. Jan. 1, 1995) (hereafter referred to as the “1995 Labor Law”).

7 ECL, Art. 7.

8 ECL, Art. 10.

9 ECL, Art. 14. If the period of work without a written agreement is more than a month but less than a year, the employer is required to pay double wages for that period. *Id.*, Art. 82.

10 ECL, Art. 37.

11 ECL, Art. 14. Presumably, the two renewals would have to occur after January 1, 2008, the ECL’s effective date.

12 ECL, Arts. 39–40. Economic dismissals are discussed below.

in China. The Deputy Chairwoman of the NPC Law Drafting Committee said as much when the law was adopted and went on to point out that concerns over increased costs are basically misguided since this law seeks to suppress plainly illegal employment practices.¹³

In a modest way, the new law seems to strengthen the role of trade unions by requiring employers to consult with them in promulgating rules and regulations, concluding employment contracts, and implementing economic dismissals.¹⁴ This development comes on the heels of the 2004 Provisions on Collective Contracts issued by the Ministry of Labour and Social Security¹⁵ and the recent “organization” efforts at Wal-Mart stores in China by the ACFTU,¹⁶ the state-sanctioned labor federation. However, given the ACFTU’s historical tendency to be more concerned with maintaining production and worker discipline than worker rights, it remains unlikely in the near term that Chinese trade unions will transform themselves into vigorous worker advocates.

SIGNIFICANT FEATURES OF THE LAW

1. Noncompete Agreements

Senior management, technical personnel, and employees with confidentiality obligations may be subject to employment provisions that restrict their ability to compete upon termination of employment. The period of the restriction cannot exceed two years.¹⁷ Under the law, companies will be obligated to pay the monthly salary of former employees during the noncompetition period.¹⁸

2. Layoffs

One role that labor bureaus in China have traditionally played for FIEs is to assist in the dismissal of workers when a plant reduces its workforce. The labor bureau in effect ensures that the workers do not demonstrate

violently. The new law carries forward this responsibility but provides some protections for workers, such as the need for management to discuss the layoffs with the labor union or worker representatives 30 days in advance; a prioritization of who should be retained if possible, such as those with long-term or indefinite-term contracts or those with children or elderly dependents; and the requirement to rehire dismissed workers if the rehiring occurs within six months of the layoff.¹⁹ Certain provisions of the 1995 Labor Law protecting workers from dismissal, such as if they have contracted an illness or are pregnant, are carried forward in the new legislation.²⁰ Although management must go through the required consultative process, so long as the layoff is in accordance with the law, it would appear that the union or workers’ representatives should not, at least in theory, be able to block the dismissal.²¹

3. Severance Pay

The Employment Contract Law does require an employer to pay severance pay in most circumstances where the worker is terminated.²² The normal rate for severance pay as specified in the Labor Law is one month’s wages for each year of service up to a 12-year maximum.

Some expatriate executives took notice of this provision and, when terminated in China, began to bring suit in Chinese courts to collect for all their years of service to the company, but at the high salary received for work in China as a foreigner. The new law effectively precludes such suits (and also for highly paid Chinese citizens) by providing that, if the monthly salary is more than three times the average monthly salary in the local area, then the severance pay of that individual is limited to three times the average monthly wage in the local area.²³

13 Xinhua News Agency, Chairman Wu Gangguo Encourages Local Governments to Protect Workers, China Congress Web at www.npc.gov.cn

14 ECL, Arts. 4, 6, and 41.

15 Samuel Estreicher, *Global Issues in Labor Law*, 188–94 (West/Thomson, 2007).

16 Jeremy Kahn, *Foreign Ventures Come to Terms with China’s Labor Unions*, *World Trade* (Dec. 2006), at www.worldtrademag.com

17 ECL, Arts. 23–24.

18 ECL, Art. 23.

19 ECL, Art. 41.

20 ECL, Art. 42.

21 ECL, Art. 43.

22 ECL, Art. 46.

23 ECL, Art. 47.

CONCLUSION

It remains to be seen what practical impact the new law and the ACFTU's declared intention to "organize" FIEs will have on employment throughout China. The country continues to move forward with embracing the rule of law, and the Employment Contract Law inches the system toward that goal. Much will depend, however, on the quality of enforcement by state authorities and whether the ACFTU can shed its historic statist orientation.

LAWYER CONTACTS

For further information, please contact your principal Firm representative or one of the lawyers listed below. General e-mail messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

Samuel Estreicher

New York
1.212.326.3488
sestreicher@jonesday.com

Barbara Mok

Hong Kong
852.3189.7207
bmok@jonesday.com

Michael J. Gray

Chicago
1.312.269.4096
mjgray@jonesday.com

Owen Nee

New York
1.212.326.3830
onee@jonesday.com

Winston Zhao

Shanghai
86.21.2201.8168
wzhao@jonesday.com

Johnson Tan

Beijing
86.10.5866.1101
jtian@jonesday.com