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EMPLOYMENT STRATEGY FOR FOREIGN INVESTORS IN CHINA AFTER THE PUBLICATION OF THE IMPLEMENTATION RULES OF THE LABOR CONTRACT LAW

Ever since the promulgation of the Labor Contract Law of People's Republic of China ("Labor Contract Law") on June 29, 2007, the prevailing view of most commentators is that the Labor Contract Law is excessively friendly to employees. Against this background, the State Council of PRC released the Implementation Rules of Labor Contract Law ("Implementation Rules") on September 18, 2008.

Unlike the Labor Contract Law, which has been criticized as being overprotective of employees, the Implementation Rules put more emphasis on balancing the interests of both the employer and the employee. Technically speaking, the Implementation Rules do not change the core principles or orientation of the Labor Contract Law; nevertheless, it is still worthwhile to note that the Implementation Rules have made some considerable changes that will have an impact on employment relations and bring new challenges to the work of human resources departments.

This *Commentary* will mainly discuss the notable changes in employment relations brought about by the Implementation Rules and their possible impact on foreign investors in China.

Compared to the Labor Law promulgated on July 5, 1994, the obvious change made in the Labor Contract Law and the Implementation Rules is that employers are encouraged to sign open-ended contracts with their employees. Previously, most employers in China tended to choose a one-year fixed-term labor contract and renew it every year. This method provided much more flexibility for employers because they could lay off the employee at the end of the one-year fixed-term labor contract without paying anything.

Under the new Labor Contract Law, this option is no longer available. Even though an employer can lay off its employees when the fixed-term labor contract expires, the employer still needs to pay severance

pay to such employees as compensation. Under these circumstances, the human resources department of a foreign investor will need to devise a strategy to respond to this change of law. For example, the human resources department may need to customize each labor contract the company will enter into with its employees in order to balance the possibility of laying off employees in the future and to minimize the amount of severance pay to the employees being laid off. Specifically, human resources departments may need to carefully evaluate whether each potential employee is qualified for his/her job. They will also need to have a good understanding of the future growth of the company in order to envisage the need for additional human resources.

Generally speaking, if the position is of great importance to the company, an open-ended contract is acceptable, especially considering the ceilings on the severance pay under the Labor Contract Law. For example, the statutory compensation to an employee whose salary is three times higher than the average salary of the city in which the company is located will be limited to three times the average salary of that city; in any event, the period for calculation of severance pay shall not be more than 12 years. This means that the maximum amount of the severance pay shall not be more than 12 times 3 times the average salary of the city. This will alleviate the financial burden to the employer when laying off high-level executives whose salaries are often considerably higher. On the other hand, if the contract is for the lowest-level employees of a company and their working competence is still in question for the company, it would be more practical to sign a shorter fixed-term contract with them before determining whether to enter into a longer fixed-term contract. The purpose of such arrangement is to allow the employer more flexibility, in the case of employees of unknown quality, to terminate a shorter term labor contract upon its natural expiration instead of having to terminate on the grounds of incompetence and risk time-consuming labor disputes if the employee challenges the reason for termination.

Another issue arises from the application of Article 14 of the Labor Contract Law, which provides that an employer is obliged to sign an open-ended labor contract with an employee if the employee has served at the company for a consecutive 10-year period. To avoid such provisions, many companies have tried to "zero" down the working years of the employees by changing the date of employment in the contract. However, this option has been closed by the Implementation Rules, which provide that the starting date of the 10 consecutive years shall be the date when the employee starts to work at the company, and not the date of signing the contract with the employer, and that the working years prior to the implementation of the Labor Contract Law will also be included. In other words, the calculation of "10 years" will start from the day when the employee begins to work in the company, which has nothing to do with the date contained in the labor contract. Such method of changing the starting date of employment in the labor contract, so as to avoid signing open-ended contracts, is now illegal.

To have a better understanding of the Labor Contract Law and the Implementation Rules, the concept of an "open-ended contract" needs to be clarified. It is not, as some people believe, a permanent contract. In fact, the employer may terminate the contract based on several conditions provided in the Implementation Rules. For example, Article 19 (3) of the Implementation Rules provides that an employer may terminate a labor contract if the employee is in serious violation of the internal rules of the company. Considering the content of the internal rules and the definition of "serious violation," employers may have some degree of flexibility if they can prepare a set of internal rules that set up clear-cut and definite standards of responsibility and working requirements for each position, so as to provide a stronger position for the employer to lay off incompetent employees. Such well-drafted internal rules will act as persuasive evidence for labor arbitrators and judges to make decisions in favor of the employer.

Employers may also need to pay special attention to the definition of "serious violation" when formulating the internal rules. It should be noted that such standards should take into account the position of the employee, the financial situation of the company, and also the industrial criteria. In other words, since there is no statutory definition of what situation is serious enough to warrant the firing of an employee, in practice, this judgment will be made by arbitrators and judges, who may have their own interpretation if there is no clear-cut and reasonable definition in the internal rules of the employer. Therefore, an employer should have internal rules that try to cover every aspect of the employment relationship, including job descriptions, responsibilities, working requirements, and consequences for breach of the rules.

The Implementation Rules have also adopted some new requirements in relation to a company's routine operation:

- Compared to the Labor Contract Law, the Implementation Rules include provisions extending to branches of companies. Article 4 of the Implementation Rules provides that a branch of a company is entitled to sign labor contracts with its employees if it obtains a business license; otherwise, it can only sign labor contracts under the authorization of the company. Article 14 of the Implementation Rules also provides that if an employee works in a different location from the place of registration of the employer/company, the salary paid to the employee and all the employment-related standards (including labor protection, working conditions, industrial danger defense, and so on) should be in accordance with the local standards. However, it further stipulates that if the salary standard and other employment-related standards of the company's place of registration are higher than those of the working location, and if both contracting parties agree so, the higher standards of salary should be applicable to the contract.

- Another issue that needs employers' attention is the new requirement on establishment of a systematic and up-to-date name list of employees. Article 8 of the Implementation Rules provides that a name list of employees must include information on the employee's name, gender, citizen identity card number, residential address, contact information, nature of employment, term of employment, and the like. To further support this requirement, Article 33 of the Implementation Rules provides respective administrative and monetary penalties for a company's violation of the Article 8 requirements. Therefore, it is suggested that employers who do not have such a detailed name list should prepare one as soon as possible.

- Another notable requirement in the Implementation Rules is that only the statutory dissolution conditions will be recognized in order to dissolve a labor contract. Specifically, in Article 13 of the Implementation Rules, it is stipulated that employers and employees may not agree on other conditions for dissolution of the labor contract other than the conditions prescribed in Article 44 of the Labor Contract Law. This provision in the Implementation Rules clearly requires that the dissolution conditions of a labor contract are statutory, and that additional or contradictory conditions cannot be agreed upon by the contracting parties. Foreign investors should note that a labor contract in China is a special type of contract, and the general principles of the Contract Law are not applicable to labor contracts.

In addition to the above new requirements addressed in the Implementation Rules, the following issues should also be considered by employers when they decide to terminate a labor contract.

- Employers are required to issue a certificate of termination of employment upon termination of the employment relationship. According to the Implementation Rules, this certificate should state the term of the contract, the date of termination, the position, and the period the employee has worked for the employer. Although there is no punishment specified in the Implementation Rules for noncompliance, it is suggested that an employer should prepare such certificate in order to avoid problems during any administrative examination and/or dispute resolution process.

- The Implementation Rules have provided clarification as to the damages and compensation that are payable when a labor contract is terminated. Article 25 of the Implementation Rules provides that the employer is not required to pay extra compensation to the employee in situations where an employer terminates a labor contract in violation of the Labor Contract Law and damages have been awarded in accordance with the Labor Contract Law that are twice the amount of the compensation/severance pay due to the employee.

- It is provided in the Labor Contract Law that if an employer legally terminates a labor contract, compensation shall be made to the employee by way of "salary payment." Article 27 of the Implementation Rules elaborates on this issue and provides that the calculation standard of the salary as compensation shall include payable salary, award, allowance, and subsidy of the employee, which is a very wide interpretation of "salary."

- The Implementation Rules further clarify that if an employee refuses to sign a written labor contract with the employer within one month after the start of the employment, the employer is entitled to dissolve the employment relationship without making any compensation to the employee.

If the period without written labor contract is more than one month but less than a year, the employer is also entitled to dissolve the employment relationship, but compensation shall be made to the employee on the basis of the actual working period. In the Implementation Rules, it is clearly provided that there is a grace period of one month for employers to terminate the employment relationship without paying damages to the employee, as stipulated in the Labor Contract Law, at the amount of twice the employee's salary.

- Article 10 of the Implementation Rules provides that if any employee was transferred to work in a new company by the employer, the working period with the old employer will be calculated into the working period of the new employer unless the original employer has paid up all the severance pay to its employees. Under this requirement, if any foreign investor acquires a Chinese company after the implementation of the Implementation Rules, it is suggested that the purchase agreement should include a clause to request the seller to pay the severance pay to its employees and deduct such amount from the purchase price. Otherwise, once the labor contract with the former employee of the seller is terminated or if the foreign investor wants to lay off any former employee of the seller, the foreign investor will incur additional expense.

Although we have addressed several topics that we think will be quite important for foreign investors to consider when they examine their human resources requirements and employment policy in China, there are still many issues that remain uncertain in the new labor law system of China. It is suggested that employers should take a closer view of the new law and implement a system of employment that is suitable to the company's actual situation. It is also very important to set up a comprehensive and detailed file system of employment-related issues in order to be well prepared for any governmental examination and future labor disputes. An unavoidable result of the Labor Contract Law and its Implementation Rules is that the costs related to employment in China will definitely increase.

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