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China Bulletin

ALERT: CHINA'S NEW LABOR CONTRACT LAW

Introduction

On June 29, 2007, the National People's Congress passed the long-anticipated Employment Contract Law of the People's Republic of China. The new law (sometimes referred to in this article as the "Labor Contract Law") will come into effect on January 1, 2008. While existing contracts that are valid under China's current labor law will still be considered binding, all new rules and regulations concerning the performance of employment contracts, worker termination and benefits will be applicable.

Written Contracts

The Labor Contract Law requires written contracts for all full-time workers. Part-time laborers, defined as persons working no more than 24 hours per week (previously 30), can still be employed without a written agreement. Under the new law, if an employer fails to conclude a contract within one month of the commencement date, the employee will be paid double the standard rate until a contract is signed. If a contract has not been signed by the first anniversary of employment, the employer and employee will be considered to be in an open-ended contract at twice the standard rate of pay. Moreover, if a contract cannot be agreed upon, the terms of the collective contract, if one exists, will apply.

Open-ended Contracts

A major change under the new law is

that employers are required to enter into open-ended employment contracts (i.e., contracts without a fixed term) with all employees who have worked for the business for more than 10 years. In addition, employers are prohibited from entering into more than two fixed-term contracts with any employee. This change makes it more difficult and costly for an employer to end a contract with an employee. The intent behind the Labor Contract Law is to discourage employers from entering into short, fixed-term contracts and then renewing them if continued employment is desired. The Labor Contract Law provides that if an employer does not enter into an open-ended contract following the employee's second fixed-term contract, the employee must be paid at twice the contract rate.

Termination

The Labor Contract Law provides that employment can be terminated upon 30 days' notice if the conditions for which an employee was hired change such that his or her job is no longer necessary and a new contract cannot be concluded, or in the event of a non-work related injury. The Labor Contract Law also regulates circumstances in which more than 20 persons (or 10% of an employer's workforce) are terminated. Now an employer may only substantially reduce its workforce if it gives 30 days' notice and the reduction is due to bankruptcy or a major change in business circumstances. If there is to be a

substantial workforce reduction, employees with open-ended contracts, lengthy fixed-term contracts, and those who are sole providers for their family or who have dependents are to be given job retention priority. Significantly, the new law requires that employees terminated as a result of a substantial workforce reduction are required to be given severance pay. Indeed, if an employee is dismissed in violation of the Labor Contract Law, he or she generally has the right to be reinstated or receive severance at twice the rate stipulated by the terminated contract.

Non-compete Provisions and Training Costs

A significant change provided by the Labor Contract Law is the reduction of the maximum duration for a non-compete period from three years to two. Another change is that the new law appears to mandate that compensation for a non-compete agreement must be paid during the restricted period (although the amount of compensation required will vary by location). Accordingly, employers may not be able to designate a portion of an employee's monthly salary as compensation for the non-competition covenant. Employers can, however, seek compensation for lost training costs. If an employer pays for an employee's job training, it can include in the contract a minimum "term of service" and liquidated damages for failure to complete that term. The liquidated damages must be limited to the

employer's costs for the job training and proportionate to the amount of the term of service completed.

Severance Pay

Under the Labor Contract Law, an additional month of salary is required for each year of employment. Employees eligible for severance pay will receive monthly payments equal to their contractual wages. An amount equal to one-half of a month's salary is payable if the employment period was less than six months. However, if an employee's wages exceed three times the average monthly wage in the region (a "highly compensated employee"), then his or her severance pay will be capped at three times the average monthly wage for a maximum period of 12 months.

Conclusions

There appear to be several motivating factors behind the Labor Contract Law. First of all, it significantly closes loopholes left open in the 1994 Labor Law that allowed employers to avoid intended labor regulations. In addition, it facilitates the Chinese government's objective of increasing the use of open-ended contracts. In general, the provisions of the Labor Contract Law are expected to result in higher costs and less flexibility for employers. This article addresses only a limited number of the changes mandated by the Labor Contract Law, and this summary is not intended to constitute legal advice. All employers in China are encouraged to review their labor contracts and employee handbooks in light of the relevant changes.

As a reminder, this Advisory is being sent to draw your attention to issues and is not to replace legal counseling.

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Additional Information

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