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An Overview of China's New
Labor Contract Law

An Overview of China's New Labor Contract Law

By [Robert Alex Clar](#)

Introduction:

The Standing Committee of the National People's Congress adopted the [Law on Employment Contracts of the People's Republic of China \("Labor Contract Law"\)](#) on June 29, 2007, with effect from January 1, 2008. The new Labor Contract Law now requires that employers enter into written contracts with all of its workers. In addition, the Labor Contract Law also deals with procedures and requirements for entering into these employment contracts, various details of employment, and final termination of the contractual relationship. This law will have significant and far-reaching implications for both foreign and local employers as it provides many new rights and protections for all Chinese employees.

Some of the more important details of the new Labor Contract Law are provided in summary below:

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Basics of the Employment Contract

Under the Labor Contract Law, the employment relationship between the employer and the employee is established by entering into an "employment contract". Employment contracts are classified as either "fixed term" or "open-ended". As the names imply, a fixed term is an employment of a definite time period. Open-ended has no such specific end date and is somewhat similar to the status of "at will" employment as is recognized in the United States. Fixed term contracts can convert to an open-ended employment contract under numerous situations, such as a long-term employment of more than 10 years. An employee can also automatically be viewed as having an open-ended contract where there is a failure to conclude a timely written employment contract within a year of commencing one's employment.

Whether open-ended or fixed term, Article 17 of the Labor Contract Law requires that an employment contract include information on duration of employment, job description, working hours, rest and leave, pay, insurance, issues of workplace protection and safety. Similar to aspects of the PRC Contract Law, an employment contract could be regarded as either invalid or partially invalid under Article 26 if one party uses some unfair advantage in the negotiation process such as deception or coercion, the employer disclaims all

legal liability, and/or the contract is somehow in violation of the law. However, the law will attempt to salvage part of the contract and excise the offending portions if the remaining contract can still function on its own.

Some employers may be interested in the length of probation periods, as many foreign jurisdictions allow for fewer benefits and pay to be accorded to probationary employees. Article 19 sets forth various timelines for probation depending on length of the contract. However, in any event, the longest probation period is 6 months, which is allowed for fixed term contracts of 3 years or longer or in an open-ended contract. The law further provides a standard of minimum pay during the probation period and restrictions on terminating the probationary employee. Lastly, an employer may only put a worker through one period of probation.

Like any contractual relationship, both sides must fully perform their obligations. One key exception exists for workers in matters where the employee refuses to perform dangerous work in violation of company regulations and/or the law. An employer and the worker may also amend the contract if both agree to do so. Like the contract, the amendment must also be in writing.

A worker can unilaterally terminate the employment contract ...

Article 38 of the Labor Contract Law

Termination of Contract and Severance Pay

Termination of the employment contract can occur under various conditions. Both sides can agree to end the contract. A contract can also simply end under certain circumstances such as expiration, death of the worker or some circumstance ending the employer (e.g., bankruptcy).

With the appropriate notice (generally 30 days), a worker can unilaterally terminate the contract under Article 38. Conditions allowing for termination of contract by the worker include failure to timely provide full pay, failure to provide the contractual working conditions, not providing employment benefits or having company rules that violate the law. A worker can immediately terminate the contract with no advance notice in certain extreme situations, such as threats or violence from the employer, or orders for work that threaten personal safety.

Employers can also unilaterally terminate the contract. Article 39 sets forth the conditions for employers to terminate a contract, which include: if the worker cannot satisfy the conditions of employment during probation, material breach of contract, engaging in “serious dereliction of duty”, practicing graft, having a business/employment relationship with another employer or committing some criminal act which is persecuted. An employer can also terminate the contract if the worker cannot engage in work after a period of sick leave due to non-work related injury or illness, a worker remains incompetent even after training or adjustment of job duties, or some major change in circumstances which renders the employment contract non-performable. The last circumstance could conceivably deal with the company entering into a rough financial period. If the employer opts to terminate the contract due to the above circumstances, he

must either give 30 days notice to the worker or dispense with the notice and pay one month's wages.

Article 41 should be of interest to foreign companies as it deals with layoffs. The Labor Contract Law allows for layoffs of 20 or more persons, or less than 20 workers if such a layoff equals 10 percent or more of the total work force. Employers are allowed to do so in times of restructuring under the recent Enterprise Bankruptcy law¹, encountering negative and/or major changes in financial circumstances, or implementing some technological change which requires a reduction in the workforce. However, the law does note that the employers need to explain the circumstances to the labor unions and its employees and to consider their "opinions".²

Also under Article 41, the employer is to give employment preference to certain "priority" persons during the process of layoffs. Such priority persons include those with open-ended employment contracts, fixed term contracts with long terms and those persons who are solely relied on by their respective families. In addition, if such persons do get laid off, they will have priority in rehiring.

Employees are protected from termination of their employment contracts under Article 42 under certain conditions such as development of injury or illness caused by the workplace, if the period for non-work related illness or injury has not expired and if a female is in a period of pregnancy or raising a newborn.

Lastly, foreign investors may be concerned by Article 46, which states that the employer will be required to pay severance under an extremely broad variety of situations. These include the previously mentioned reasons a worker can terminate his employment contract (Article 38), where both parties agree to severance, or in situations where the employer undergoes bankruptcy/liquidation or is ordered shutdown by the government. Presumably, employers would be least pleased at being required to pay severance while undergoing bankruptcy. In most situations, severance pay is calculated at a rate of one-month pay per year of employment.

Role of Labor Unions

The labor union is a critical player in the employment process under the new Labor Contract Law. One of their duties is to jointly coordinate with both the local labor administration authorities and the employer, and address/resolve any employment issues. In terms of the employment contract, the labor union is also supposed to "assist and guide" workers in negotiating with the employer. As previously mentioned, the union will be advised and consulted with prior to any major layoffs of the workforce. However, labor unions are also supposed to be advised of the employer's termination of any employment contract, along with providing a reason for the termination. The labor union also has the right to demand that the employer rectify any legal violations or violation of the provisions of one's employment contract.

Layoffs:
Employers may layoff 20 or more persons, but need to explain such circumstances to the labor unions and its employees to consider their "opinions"; in addition, preference to "priority" persons must be given during such process ...

Article 41 of the Labor Contract Law

¹ The PRC Enterprise Bankruptcy Law was put into effect on June 1, 2007.

² Earlier drafts of the law required approval of the union to engage in layoffs. However, various foreign companies reviewing these drafts complained about having such a provision to the government. The "notification" language appears to be a compromise between the government, foreign companies and labor interests.

The new Labor Contract Law provides for the device of collective bargaining by the labor unions for conclusion of “collective contracts”. In fact, collective contracts are only to be concluded by the unions. Matters of compensation, hours of work, rest and various benefits can be addressed by collective contracts. Furthermore, the collective contracts need not be confined to a single company. An industry-wide contract can be negotiated. It should be noted that in negotiating these contracts, pay and job conditions may not be lower than those prescribed by the local People’s government. In turn, pay and job conditions negotiated on an individual employment contract may not be lower than that set in a collective contract.

Role of the Government

Under the Labor Contract Law, the various labor administration authorities (both the Labor Administration attached to the State Council and its equivalent at the local county level) will be responsible for implementation of the new law and contract system, monitoring of employers and for administering legal penalties.

In terms of monitoring, county labor authorities will be responsible for making certain that employers in their respective jurisdictions adhere to the new law. Article 74 sets forth a list of employment issues that the authorities will monitor, which include: formulation of internal company rules and regulations on workers; compliance with regulations on hours, leave, and various required employment benefits; and matters of pay.

Under Article 75, employers should further be aware that the labor administration authorities have the power to review any and all employment contracts and related material, which could be conducted through on-site inspections. Both employers and employees have a duty to provide such material for these monitoring activities. Under Article 79, both workers and employers also have the additional duty to report violations of the labor law to the labor authorities and that such authorities in turn will investigate any complaints.

Legal Liability

Chapter 7 of the Labor Contract Law gives the labor administration authority the power to order employers to correct various situations that violate the law and to (initially) give a corresponding warning. Such violations include entering into employment contracts that lack mandatory provisions, enacting internal company rules that violate the Labor Contract Law, extending the probation period of employment beyond the legal limit, or failing to issue the correct paperwork to workers upon termination of the employment contract. Furthermore, specific administrative fines can be ordered in matters where the employer keeps the worker’s residency papers and ID, improperly obtaining and holding personal property of a worker and keeping the worker’s paperwork past termination of employment.

The employer is also subject to civil liabilities if any of the above transgressions cause actual damage. In addition, there is civil liability in matters where the employer acts in a “tortuous” way toward the employees (e.g. threats, physical violence, detainment, illegal searches), and orders workers to perform dangerous work that is illegal or in work conditions that result in harm to the worker (a polluted environment). Under Article 88, the tortuous acts may also subject the employer to administrative and criminal liabilities.

When it comes to issues of pay, Chapter 7 of the Labor Contract Law sets forth specific rates or standards of compensation. For example in such matters as paying below a minimum rate, not paying overtime or failure to pay the correct severance pay, employers have to make up the shortfall and if the pay is not made within the time limit set by the labor administration authorities, employers will be assessed fines equivalent to 50 – 100% of the amount payable (Article 85).

Other than the employer, employees can also be held civilly liable for unlawfully terminating the employment contract, breaching a confidentiality clause or breaching a non-competition clause. Both the employer and the employee can also be held civilly liable (jointly and severally) if the employer hires a worker whose employment contract was not terminated and this causes damage to the prior employer.

Administrative and civil liabilities exist for staffing firms (providers of laborers, see below) who violate the Labor Contract Law. The hirer of the firms may also be jointly and severally liable if the worker is harmed. A similar type of joint and several liability also exists in Article 94 for individuals that hire a business who in turn hires workers in violation of the law and such workers are harmed.

Lastly, Article 95 places civil liability on the labor administration authority or other relevant government officials/ministries, if they fail to perform their duties and such failure results in harm to the worker. Such government officials could also face administrative fines and criminal penalties.

Other Features:

The Labor Contract Law allows for the establishment of “staffing firms”. Staffing firms will operate according to the Company Law and be capitalized at RMB500,000 or more. The law also sets forth the responsibilities of the staffing firm toward its workers, which are generally the same obligations of an employer toward its employees under this Law.

The Labor Contract Law also addresses part-time labor, which is defined as those who work not more than 24 hours a week. Like full-time workers, the new law sets forth requirements on contracting, hourly pay and termination.

Conclusion:

The Chinese media has reported that the national government has been aware of recent employment scandals which involved abusive methods by employers to compel overtime work at very low wages (or in some cases, none at all), which has translated into social unrest. As such, much of the new Labor Contract Law was designed to strengthen the rights of workers in relation to management. Everything must now be addressed in a written employment contract, with matters of pay, hours and benefits all clearly defined. In addition, since various high profile employment scandals also involved local government officials, an interesting addition of the Labor Contract Law is the placing of potential liabilities on the authorities that are responsible for monitoring the process.

The new Labor Law is somewhat unusual as the government allowed for the release of early drafts of the law and also elicited comments from outsiders. While the law provides various new rights and powers for workers/employees, the government also apparently softened original details in the earlier drafts in order to meet the concerns of foreign business interests. No doubt, there will be a continuing debate between labor activists and employers as to who got the better deal in the new Labor Contract Law.

From the perspective of foreign investors, certain key aspects of the new Labor Contract Law may be troublesome or of immediate concern. One issue is the insertion of unions into a primary bargaining role on both individual and collective employment agreements. In addition, severance pay seems to be required of employers in a large number of situations including where the employer is going through bankruptcy. Lastly, employers need to be aware of the new detailed requirements for termination and/or layoff of workers, which again involves labor unions.

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