

New 2008 China Labor Contract Law

Introduction

On January 1, 2008, a new Labor Contract Law took effect in China. The law aims primarily to protect the interests of blue collar workers.

According to Chinese government officials, the new regulations will curb the rising tide of labor disputes and should ultimately increase worker loyalty to employers. Many foreign firms, however, fear that resulting increases in labor costs will negatively impact their operations in China.

Major changes to the new law include increased regulations on written labor contracts, use of temporary workers, and severance pay. This article will provide an examination of the new regulations in the Labor Contract Law and how these regulations will effect Western businesses in China.

Background on Chinese Labor Legislation

For several decades after the establishment of the People's Republic of China in 1949, China's Communist government promoted an "iron rice bowl" system. Under this system, workers were guaranteed lifetime employment, food, housing, and even clothing. Few regulations were enforced with regard to worker rights and employment contracts were non-existent. Today, the Iron Rice Bowl System is slowly dying out, but can still be seen in many state-owned enterprises (SOEs).

China's most significant labor legislation is the National Labor Law of the People's Republic of China, effective January 1, 1995. The passage of this law marked a significant step in the movement away from the socialist labor system. It standardized labor policies for both foreign and domestic firms in China, including regulations on discrimination, working hours, wages, labor safety, social insurance, labor disputes and labor contracts.

The 2008 Labor Contract Law

Although basic labor contract regulations were already laid out under the 1995 Labor Law, many small and medium-sized local Chinese enterprises still do not have employment contracts with their workers. Some foreign firms in China also currently lack written contracts.

In March 2006, the Chinese legislature released its first draft of a new Labor Contract Law. Soon afterward, the National People's Congress (NPC) announced an unprecedented "open comment period," for companies, organizations, and individuals to submit comments and complaints on the proposed law. Over 200,000 responses were recorded, including detailed complaints from the American Chamber of Commerce in Shanghai and the European Chamber of Commerce in China.

In February 2007, an updated draft was released. This draft included many changes made as a result of the suggestions received during the open comment period. In July 2007, the Labor

Contract Law was finally passed. It officially came into effect on January 1, 2008. The law contains 98 articles divided into 8 chapters.

General Provisions

In scope, the Labor Contract Law is similar to the 1995 labor law. The Labor Contract Law applies to both foreign and domestic enterprises in China, but not to foreign representative offices in China.

The 1995 labor law guaranteed workers' rights in the areas of compensation, work hours, job safety, insurance and benefits, training programs, and work discipline. The new 2008 law takes these rights a step further, requiring employers to notify employees of any changes to company rules or regulations regarding these topics. An employee representative must also be allowed to consult with the employer and file complaints.

The 2008 law also gives unions express permission to organize workers at all enterprises. Although unions are not required at companies in China, unionization must be allowed. If established, unions can assist with contract negotiation and establish collective bargaining mechanisms.

Although given substantial legal power under the Trade Union Law in 2001, labor unions had little to no real power in China until recently. The All China Federation of Trade Unions (ACFTU) is a government-run organization that has been implementing aggressive unionization tactics aimed at foreign companies in China since the middle of 2006. The ACFTU announced last year that it plans to unionize all foreign-invested enterprises (FIEs) in China by mid-2008. This deadline will not likely be met.

Types and Content of Labor Contracts

The 1995 Labor Law recommended written contracts, but was vague on actual requirements. Under the 2008 law, written contracts are required for all full-time workers. These must be established within one month of the employee's start date. Collective contracts with unions are acceptable in the absence of individual contracts.

The Labor Contract Law defines three types of labor contracts: fixed-term, open-ended, and task-based. In a fixed-term contract, an ending date is agreed upon. There is no legally specified minimum or maximum length for fixed-term contracts.

Open-ended contracts have no stipulated ending date. The new law requires open-ended contracts to be signed if an employee has been with the same employer for 10 or more years or if a fixed-term contract has been renewed more than twice consecutively. An open-ended contract is also assumed to exist by the law if an employer fails to establish a written contract with an employee for a period of one year. In a task-based contract, the employer and employee agree that the contract will end when a specific task has been completed.

The 2008 Labor Contract Law also includes some stipulations with regard to the contents of labor contracts beyond the basic requirements of the 1995 law. Under the new requirements, social insurance information, job location, and the identity document number of the worker must be

included in a written labor contract.

Probation Periods, Training and Confidentiality

The 1995 labor law contains only one line referring briefly to probation periods, stating that a probation period “shall not exceed six months.” The new 2008 law defines probation periods much more specifically. No probation period is allowed for contracts lasting less than 3 months or for task-based contracts. For contracts lasting between 3 months and 1 year in duration, no more than 1 month probation period is permitted. For contracts between 1 year and 3 years in duration, no more than 2 months’ probation period is permitted. Finally, contracts lasting 3 or more years and open-ended contracts are allowed 6-month probation periods.

During the probation period, pay may be no less than 80% of full wage in the contract. Pay in the probation period may also not be below the minimum wage or below the lowest wage paid at the same company for the same job.

The new Labor Contract Law also gives employers the right to require workers to sign a contract for a minimum time of service after training. Employees who breach the contract can be held liable for the full cost of the training, pro-rated based on the minimum time of service remaining.

Confidentiality is another issue clarified by the new 2008 law. The law allows for companies to require employees to keep trade secrets confidential. Maximum damages for breach of a confidentiality agreement should be stipulated clearly in the written employment contract. For senior management and senior technician roles, companies may also include non-compete clauses in labor contracts. Such clauses may be up to 2 years in duration and damages for violation should be stipulated in the contract. The law sets no other limits or guidelines for non-compete clauses.

Termination of Employment Contracts and Severance Pay

Supplementing the 1995 law, the new 2008 law provides a complex set of rules for terminating employment contracts. Under the new law, when unilaterally terminating employees for any reason, a company must first give notice to applicable labor unions. However, union approval for termination is not required.

- As in the past, termination without severance pay is allowed only when an employee is in serious violation of federal, local, or company regulations. Severance pay and 30 days’ notice are required when terminating employees in any of the following situations;
- Employee can no longer work due to a non-work-related injury;
- Employee is deemed incompetent to perform duties of the job;
- Major change in circumstances making it impossible for the employee to fulfill the duties of the contract;
- Mutual agreement;

Severance pay and 30 days’ notice are also required when restructuring due to bankruptcy or serious difficulty with production or business operation. This is defined as a situation in which 20

or more employees (or 10% of total employees) must be terminated in order to keep the business in operation. Under these circumstances, the law requires that priority to remain at the company must be given to those with the longest-term fixed contracts, those who are the primary breadwinners for their families, and those who are caring for elderly family members or small children.

Severance pay in China is based on the number of years worked. One month's wage is required for each full year worked. The maximum total severance pay for any employee is 12 times three months' average monthly wage of the local district.

Under certain circumstances, the Labor Contract Law does not allow termination for any reason:

- The employee has sustained a work-related injury;
- The employee is still in recovery from a non-work related illness or injury;
- A female employee is pregnant or nursing;
- An employee has been working continuously for the same employer for 15 years or more and is less than 5 years from retirement;

Placement Firms and Part-Time Labor

Under the 2008 Labor Contract Law, staffing firms are treated as employers. Contracts between employees and staffing firms must be at least 2 years in duration. When there is no work for those under contract, staffing firms are directly responsible for paying them at least minimum wage. Contracts can also be drawn up between staffing firms and hiring companies to determine the term of placement. Employees placed by staffing firms have the same rights as regular employees at a company and are allowed to join unions at the hiring company or at the staffing firm.

The 2008 law also establishes clear regulations with regard to part-time labor. Any job which requires less than 4 hours per day or 24 hours per week is considered to be part-time. Oral contracts are acceptable for part-time workers. No probation period is allowed. Neither severance pay nor notice of termination is required.

Monitoring and Legal Liability

Enforcement of laws in China often varies widely from region to region. The Labor Contract Law is enforceable at the county level, so implementation is likely to be very different between regions. Local government officials are given the right to conduct random monitoring inspections and labor unions are encouraged to ensure that all labor regulations are followed. This may constitute the most serious threat to foreign companies, which are often targeted by labor unions.

The new law also details legal liabilities for employers found to be in violation of certain regulations. The most important instances are described below.

If an employer is found to have no written contract with an employee after more than one month of work, the employer must pay the employee an additional month's wage for each month worked without a contract.

If an employer is found to be paying employees below minimum wage or refuses to pay for overtime, it will be required to pay the balance due upfront. If compliance is not timely, the company will be required to pay an additional 50% to 100% to the employee, as determined by local courts. Under circumstances in which an employee is terminated without just cause, he or she will be awarded twice the normal severance pay due.

Finally, if a company hires an employee who is under contract elsewhere and the initial employer files a complaint, both the employee and the new employer will be jointly responsible for damages. The law, however, does not stipulate actual monetary liability levels.

Practical Implications

Some estimates predict that a 10% to 20% cost increase can be expected for foreign companies operating in areas of China where the new 2008 Labor Contract Law is strictly enforced. Companies in the construction, textile, and food processing industries are expected to be particularly hard hit.

Enforcement will likely be less strict away from the major coastal cities like Beijing, Shanghai, Guangzhou and Shenzhen. In addition, inland provinces often have lower non-labor costs and lower minimum wage requirements. For this reason, many foreign companies have begun plans to shift production inland to such provinces as Hunan and Anhui.

Legal experts point out that Labor Contract Law is very ambiguous in terms of actual penalties (or maximum damages) for violation of the law. This means that companies brought to court by employees or unions will be at the mercy of Chinese judges' interpretation of the law.

Although proactive enforcement of labor laws in China has been quite rare in the past, labor dispute lawsuits have become increasingly prevalent in recent years. This is especially true in Shanghai and the southern province of Guangdong. Labor lawsuits have increased by 600% in the past decade in Shanghai, with more than 18,000 suits now filed annually. More than three quarters of these lawsuits were won by workers. There is generally no limit on the amount of compensation that a worker can be awarded for wrongful termination, although an arbitration process is required before settlement.

At present, there have not yet been any major reports of enforcement of the 2008 Labor Contract Law in China, although several companies were charged with attempted circumvention of the law before its implementation in late 2007.

One of these companies was Huawei Technologies, a large Chinese telecommunications equipment supplier. The company allegedly asked more than 7,000 employees who had worked 8 or more years to "voluntarily resign" near the end of last year. The company then planned to re-sign new fixed-term contracts with the employees, who would have to compete for new positions. This was meant to delay the effects of the new labor regulations, which would only apply after the renewed contracts had expired.

The ACFTU and other unions in Guangdong Province and Shenzhen City pressured Huawei to solicit opinions from workers before carrying out the plan. Huawei and ACFTU officials met and came to a resolution before the plan was implemented. Western companies ranging from Wal-Mart to Otis Elevator to Carrefour were all accused of similar schemes in late 2007 and were met with union pressure. This is expected to be the trend of future enforcement of the labor law. Foreign firms must keep up with China's 2008 Labor Contract Law to ensure success in the Chinese market.