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Social Insurance Updates: Compliance Rates Remain Low and China–Netherlands Social Security Treaty Comes into Force

We report on two updates regarding China's social insurance system. Firstly, on a survey which shows that social insurance compliance rates remain low among companies in China, and secondly, on how China has implemented its social security totalization treaty with the Netherlands.

Social insurance compliance rates remain low

A recent survey conducted by a social insurance payroll vendor revealed that social insurance compliance rates remain low among companies in China. Of the companies surveyed:

- only 24% are compliant and using the correct base amounts for determining employee social insurance contributions
- 22.9% are using the minimum floor amount as the base amount for all employees to lower costs (the floor amount should only be used for employees whose actual salary is lower than the minimum floor).

According to the PRC Social Insurance Law, a company using artificially low base amounts to underpay social insurance contributions can be ordered to:

1. rectify and make back payments within a specified time,
2. pay a late payment charge of 0.05% of the unpaid amount per day from the original contribution due date, and
3. pay a fine of one to three times the unpaid amount if the company does not rectify and make back payments within the specified time.

China implements social security treaty with the Netherlands

In August, the Ministry of Human Resources and Social Security (MOHRSS) announced that China would implement the China–Netherlands Social Security Treaty from September 1, 2017.

According to the treaty, employees who have been working for a company in the Netherlands for at least one month before being seconded to work in China may be exempted from making pension and unemployment insurance contributions in China (but they still need to make medical insurance contributions in China).

However, the exemption is not automatic. A secondee from the Netherlands must submit to the PRC social insurance authority an official certificate issued by the Netherlands social insurance authority proving the secondee has been making social insurance payments in the Netherlands. If the secondee cannot provide the certificate, the secondee will need to make social insurance contributions in China, the same as Chinese nationals.

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The China–Netherlands Social Security Treaty is the seventh social security treaty implemented by China. The previous six implemented treaties were with Germany, South Korea, Denmark, Canada, Finland, and Switzerland. China has also signed social security treaties with France and Spain but has not yet officially implemented them.

Key take-away points:

In recent years, employees have become more aggressive in asserting their social insurance rights through administrative complaints and labor unrest. The social insurance survey results show that many employers are exposed to these risks by not complying with their social insurance contribution obligations. To avoid these complaints and labor unrest, employers should follow all rules in making social insurance contributions.

As for the China–Netherlands Social Security Treaty, any employer wishing to obtain social insurance exemptions for its secondees from the Netherlands should consult with the local social insurance center as documentary requirements for the exemption may vary by locality.

Long-term Work Permits Available in China

Starting from June 2017, PRC local labor authorities implemented the new streamlined and unified nationwide work permit assessment system. Under this new system, foreign nationals can now obtain long-term work permits in China. Foreign nationals who meet the eligibility requirements for Type A work permits as High-Level Foreign Talents can obtain work permits for up to five years. In practice, however, local labor authorities maintain broad discretion on whether to approve long-term work permits.

In some jurisdictions like Beijing, foreign nationals classified as High-Level Foreign Talents (Type A) currently can apply for a five-year work permit as their first work permit application. However, in other jurisdictions like Shanghai, foreign nationals regardless of category currently are only permitted to apply for a one-year work permit as their first work permit application.

For all applications, foreign nationals classified as Foreign Professional Talents (Type B) currently can obtain up to a three-year work permit in Beijing. The official maximum validity for Type B work permits remains one year in Shanghai.

Key take-away points:

Companies should continually check local policies regarding length of work permit validity when applying for a work permit, as local policies may change from time to time, and there may be opportunities to apply for longer work permits than in the past.

Work Permit Requirements Clarified for Foreign Nationals Working with Foreign NGOs in China

On July 27, 2017, the State Administration of Foreign Experts Affairs and the Ministry of Public Security jointly issued a notice providing guidance on work permit applications for foreign nationals working for NGOs with or without a legal presence in the PRC.

Under the guidance, if a foreign NGO has a representative office in China**,** the chief representative of the representative office who fulfils the criteria for High-Level Foreign Talents or who can provide recommendation letters from the administrative authorities may be granted a 5-year work permit. PRC local labor authorities may relax the typical qualification requirements for a work permit (age, bachelor's degree or above, two-years full-time experience, etc.) for chief representatives and ordinary representatives.

A foreign NGO with no PRC legal presence should file a recordal with local authorities to perform temporary activities in the PRC and obtain work authorization for its foreign national employees if the foreign NGO does any of the following: (i) sends foreign nationals to conduct temporary activities; (ii) sends foreign nationals to conduct work activities for no more than 90 days (the short-term work permit may be applied for online); and (iii) seconds/assigns foreign nationals to conduct work activities for more than 90 days but less than one year (these foreign nationals will need to complete a formal work authorization process with the typical application documents being required).

Key take-away points:

The July notice only provides high level guidelines, and at this stage, no separate detailed implementation rules exist for the work permit process as it relates to foreign NGOs operating in the PRC. Local labour officials have commented that the same work permit requirements apply to foreign nationals regardless of whether they are working for an NGO or another enterprise. However, local authorities in different jurisdictions can have vastly different interpretations on how to implement these requirements. Therefore, before sending a foreign national employee to the PRC, an NGO should first review the foreign national's eligibility to receive a PRC work permit in the locality where the employee will work.

Jiangsu Province Labor Arbitration Committee Provides Guidance on Controversial Labor Questions

On July 3, 2017, the Jiangsu Province Labor Arbitration Committee issued the *Meeting Minutes on Controversial Issues Concerning Ruling on Labor Dispute Cases* to guide labor arbitration committees in Jiangsu Province when ruling on labor dispute arbitrations. The minutes will likely influence how local arbitrators handle labor arbitration disputes in Jiangsu Province.

Key highlights from the minutes include:

- Special labor relationship with retirement age employees: The employment relationship with an employee who has reached the statutory retirement age but has not received pension insurance benefits

or drawn a pension should be deemed as a "special labor relationship", under which the employee is entitled to remuneration, labor protection, working hours protection, etc., but is not entitled to severance compensation or an open term employment contract.

- Fixed-term employment contract enforceability: If an employee meets the conditions for an open term employment contract but instead signs a fixed term employment contract, the fixed term contract is valid unless the employee can prove the contract was signed as a result of fraudulent misrepresentation, coercion or duress caused by the employer. However, the Labor Contract Regulations of Jiangsu Province currently require employers to inform an employee entitled to an open-term contract about the employee's open-term right before the expiry of the employment contract, and it is unclear whether this requirement will still apply or whether employers simply need to show no coercion or fraud was used based on this guidance.

- Termination: If an employer fails to establish an employee's social insurance account, the employee can terminate the employment contract and claim severance from the employer. However, if the employer establishes the social insurance account but fails to pay the social insurance premium in full, the employee cannot terminate the employment contract and claim severance. Instead, the employee can petition the labor or social security bureau for assistance.

- Electronic evidence: Electronic evidence may not be the sole legal basis to determine case facts during arbitration unless the electronic evidence is notarized, or authenticated by a forensics expert. In addition, for WeChat and QQ chat records, the arbitrator must identify the parties in the chat and examine the integrity of the chat record. Electronic evidence includes emails, WeChat messages, Weibo messages, QQ messages, mobile phone text messages, etc.

Key take-away points:

The minutes address several controversial labor dispute issues. Employers in Jiangsu Province should familiarize themselves with the minutes before handling any future labor disputes. In particular, employers should notarize electronic evidence while collecting it and provide other evidence to supplement the electronic evidence in order to ensure sufficient proof for the underlying claim.

MOHRSS Adjusts Work-Related Injury Insurance Benefits

On July 28, 2017, the Ministry of Human Resources and Social Security issued the *Guideline on the Adjustment of Work-Related Injury Insurance Benefits and Qualification Mechanism*. The guideline reiterated that government officials should consider various factors when determining whether and how to adjust work-related injury insurance benefits, such as average wage growth, consumer price index changes, the payment ability of the work-related insurance fund, and adjustments in other relevant social security benefits. The guideline used that factor analysis to adjust the disability living allowance, the bereaved family pension, the nursing fee for the disabled, and the subsidy for hospital food.

Specifically, the calculation formulas for both the disability living allowance for first to fourth grade disabilities and also for the bereaved family pension have been revised. Moreover, the subsidy for hospital food and the nursing fee for the disabled will also be adjusted to ensure fairness. Except for these four benefits specifically adjusted by the guideline, all other work-related injury insurance benefits under national law and local policy remain unchanged.

Key take-away points:

For the most part, these work-related injury benefits will be calculated and paid directly by the work injury social insurance fund according to the most current benefit standards. Thus, employers by and large have no action to take in response to the guideline. However, employers should continue to monitor the local implementation of the guideline for further adjustments to work-injury insurance benefits as those adjustments may affect employer contributions.

Equity Incentives Ruled to be Part of Labor Compensation

The Shenzhen Qianhai Cooperation Zone People's Court recently ruled that the claw back of restricted stock units (RSUs) upon termination of employment was illegal. This ruling represents one of the first occassions the claw back of RSUs was ruled as an employment matter. Until now, disputes related to employee equity incentives have generally been deemed as civil disputes instead of employment disputes.

The employee was granted RSUs under the employer's RSU incentive plan. The vested RSUs were subject to a lock-up period and would be released in three batches. The employer later terminated the employee for a serious violation of company policy shortly before the first batch of RSUs was due to be released. These unreleased RSUs were clawed back by the company upon the termination.

The employee filed an employment arbitration claim for unlawful termination and for compensation of losses for the claw back of the RSUs. The employment arbitration tribunal ruled in favor of the employee on the unlawful termination claim, but it did not rule on the compensation claim. Instead, the tribunal said that the RSU losses were outside the scope of an employment dispute. The employee then challenged the arbitration decision in court.

In ruling for the employee, the court stated that the RSUs "embody the strong characteristics of being a part of the employment relationship." First, the RSU incentive plan incentivized the employee to work for the company. Second, the RSU release was subject to the employee's performance during a specified period of employment. Finally, once the employee met the conditions under the RSU incentive plan, the employee could sell the stocks received from the RSU incentive plan at market price; therefore, the sales proceeds constituted a part of the employee's remuneration with the company. Thus, the court ruled that the company must compensate the employee for the clawed-back first batch of RSUs at the average closing price for the last 20 trading days before the employee filed the court claim. The court did not support the employee's claim for the second and third batches of RSUs since the conditions for release had not been met.

Key take-away points:

In China, disputes related to employee equity incentives have generally been resolved as civil disputes instead of employment disputes, which gives employers a lot more flexibility with respect to setting the terms for and implementation of such plans. Although some details in this case remain unclear (such as the relationship between the listed company and the employer, and whether the listed company was an overseas or domestic company), this case shows that courts (at least in the special cooperation zone in Shenzhen, where many financial firms are located) might consider equity incentives to be a part of an employee's remuneration and therefore take a stricter look at claw back provisions under an equity incentive plan.

Former Employee and His New Company Ordered to Pay RMB 5 million to Former Employer for Trade Secret Infringement

In July 2017, the Beijing High People's Court released its final judgment in a tort case in which a high-tech enterprise sued its former employee and his new company for infringing the enterprise's trade secrets. The court supported the lower court's decision that the employee and his company had infringed the enterprise's trade secrets and the lower court's order that they jointly pay the enterprise RMB 5 million for losses and reasonable legal expenses.

The employee supervised the enterprise's Malaysia business from 2003 to 2011. During this time, the enterprise hired a local Malaysian company as its agent to sell products to the Malaysian government. The enterprise and the agent signed a series of sales contracts with product parameters and sale prices that were protected under confidentiality provisions.

In March 2011, the employee resigned. The enterprise and employee did not sign a post-termination non-competition restriction when the employee left the company. Instead, the enterprise relied on a confidentiality agreement that had been previously signed with the employee to protect its commercial information. One month later, the employee established his own company.

The employee's new company and the Malaysian agent worked together to win a 2011 Malaysian government project. The enterprise brought an action against the former employee for violating its trade secrets and against the employee's new company for profiting from those unlawfully obtained trade secrets.

The employee and his new company argued that the commercial information they had used was not a trade secret. The court, however, found that the information did constitute trade secrets because the enterprise took specific protection measures (e.g., the confidentiality agreement with the employee and the confidentiality provisions in the sales contracts with the agent) to protect information that was unknown to people working within the industry.

The court further found that the employee had learned these trade secrets during his employment with the enterprise and had established his own company to use the trade secrets to win the project with the Malaysian government. Thus, he and his company had knowingly violated trade secret protections and engaged in unfair competition. Consequently, the court

ordered the employee and his company to be jointly liable for the enterprise's losses and reasonable legal expenses.

Key take-away points:

This case serves notice that companies can receive court protection of their trade secrets if certain appropriate actions are taken, such as signing confidentiality agreements with employees and appropriately marking important commercial information as "confidential." Moreover, this case also serves notice that companies should prevent their current employees from knowingly using another company's trade secrets for the current company's benefit; otherwise, the current company may be exposed to joint liability for the damages.

Additionally, companies operating in China should be aware that the PRC Anti-Unfair Competition Law is currently undergoing an amendment. The second draft of the amended law, circulated in September 2017, added liability for any third party who knows or should know that a trade secret is illegally obtained by the trade secret owner's employee or former employee, but who still accepts, publishes, uses or allows another to use the trade secret. The draft permits damages of up to RMB 3 million if the trade secret owner's actual losses or the infringer's benefits are difficult to determine.

Termination Without Specifying Termination Ground Ruled Unlawful

Recently, the Taicang Municipal Court in Jiangsu Province upheld a wrongful termination claim from an employee who was summarily dismissed without being given a reason for the termination.

The employer argued that it had terminated the employee for disciplinary violations. The employer said that it had not stated the termination ground (i.e., misconduct) in the termination notice because it did not want to negatively affect the employee's employment prospects in case a prospective employer would have asked to see the termination notice. So, the employer sent a unilateral termination notice only stating the termination date and asking the employee to complete separation formalities and work hand-over procedures. The employee rejected the termination notice and filed a wrongful termination claim with the court.

The count ruled that the termination was unlawful because the employer did not meet its burden to prove the unilateral termination was based on legal grounds. In ruling that the employer had not met its burden of proof, the court also considered it significant that the employer did not follow the common practice of including a termination ground in the termination notice. Thus, the court ordered the employer to pay wrongful termination compensation to the employee.

Key take-away points:

Although there is no legal requirement to include a termination ground in the termination notice, this case shows that courts may view its absence unfavorably to an employer when weighing evidence on whether a termination was lawful. Therefore, a termination ground should be clearly stated in the unilateral termination notice, regardless of whether the employer is concerned about damaging an employee's future employment prospects.

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Company Ordered to Pay RMB 10,000 for Revoking Offer Letter

Recently, the Shanghai Jing'an District People's Court ordered an investment company to pay RMB 10,000 in damages for revoking an offer letter to an employment candidate who had accepted the offer and resigned from his current position.

The employment candidate accepted an employment offer from the investment company. After which, he submitted a resignation letter to his current employer. Before reporting to work, he received a notice from the company's HR stating that his start date would be postponed for an unlimited period as his offer had been rejected by the group company.

The employment candidate sued the investment company for revoking the employment offer. The company argued that it revoked the offer because the employment candidate had lied on his resume. The court, however, found that the company name on the employment candidate's resume was an affiliate of his prior employer and therefore his job history was authentic.

The court found that the investment company was at fault for causing the employment candidate's unemployment and hence was liable for damages. The court ordered RMB 10,000 in damages based on various factors, including the employment candidate's monthly salary before resignation (RMB 17,000), the salary amount offered by the company, and the degree of fault of the company.

Key take-away points:

Employers will be held liable for revoking an employment offer to an employment candidate without a justifiable reason if the employment offer has induced the employment candidate to resign from their current position. Before revoking an employment offer, employers should be sure there is a justifiable reason. Courts will apply the principle of fairness in their own discretion when evaluating the revocation of an employment offer revocation.