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China Employment Law Update

Newsletter

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Hong Kong, Taiwan and Macau residents no longer need work permits to work in mainland China

On 3 August 2018, the State Counsel issued a circular to abolish employment permit requirements for Hong Kong, Taiwan and Macau residents to work in mainland China. Further details can be found in the client alert and other updates on the same issued by our immigration group.

Local tax authorities will collect all social insurance contributions starting 1 January 2019

On 20 July 2018, the General Office of the Communist Party of China Central Committee and the General Office of the State Council issued the *Reform Plan on Collection and Management of National Tax and Local Tax*. According to the plan, starting from 1 January 2019, the local tax authorities will be responsible for collecting all social insurance contributions (i.e., pension, medical insurance, work injury insurance, unemployment insurance and maternity insurance).

According to a 1999 national rule on the collection of social insurance contributions, local governments determined who would be responsible for collecting social insurance contributions. Local governments could assign the responsibility to the local tax authority or the local social insurance authority. The Social Insurance Law, effective as of 2011, did not disturb the local governments' discretion on this point.

As a result, no uniform government authority is currently responsible for collecting social insurance contributions. In some locations (such as Guangdong and Jiangsu provinces), the social insurance contributions are collected by local tax authorities. In other locations (such as Shanghai), the contributions are collected by the local social insurance authorities.

Key takeaway points:

Underpayment of social insurance contributions is a widespread non-compliance issue in China. As local social insurance bureaus do not have access to employee salary information, companies in practice have been underpaying the social insurance contributions by using a contribution base lower than the statutory standard, which is usually the employee's actual salary subject to various caps and limitations. Once the local tax authorities start collecting social insurance contributions, companies underpaying those contributions are more likely to be caught because the local tax authorities have employee salary information and can verify whether the correct contribution base is being used.

China signs social security treaty with Japan

In May, the Ministry of Human Resources and Social Security (MOHRSS) announced that China had signed a bilateral social security treaty with Japan.

According to the MOHRSS announcement, Japanese companies operating in China and their Japanese employees posted in China can be exempted from China's pension contributions. The MOHRSS announcement did not address China's other four social insurance funds, i.e., medical, unemployment, maternity and work injury. Nonetheless, even if the treaty does not cover the other four social insurance funds, the treaty will still result in savings for these employers and their Japanese employees because the pension exemption would eliminate the highest cost among China's five social insurance contributions.

The treaty will come into force once both Japan and China have complied with the legally mandated approval procedures in their respective jurisdictions. The full text of the treaty will be made available at that time.

So far, China has reportedly signed bilateral social security totalization treaties with Germany, Korea, Denmark, Finland, Canada, Switzerland, Netherlands, France, Spain, Luxembourg and Serbia.

Key takeaway points:

Foreigners working in China have been required to make social insurance contributions since 2011. Many of China's bilateral social security totalization treaties currently in effect seek to reduce the social insurance burden on these employees and their employers. However, local implementation of these treaties varies. Particularly in small cities, local officials may be unfamiliar with the treaties and therefore be reluctant to grant the social insurance exemptions. Thus, Japanese companies will need to wait until the new treaty is implemented at the local level to see whether and how the pension exemption can be obtained.

New local regulations promote sex-neutral hiring practices and workplace protections for female employees

Shenzhen municipality and Jiangsu Province recently issued standards and rules to strengthen sex-neutral hiring practices and workplace protections for female employees. These new standards and rules are part of a wider and continuing trend among local governments to promote gender equality.

Shenzhen Municipality

On 3 July 2018, the Shenzhen Municipal Human Resources and Social Security Bureau issued the *Notice on Standardizing Decision-making on Administrative Penalties Under the Shenzhen Regulations on the Promotion of Sex Equality*. Specifically, the notice provides detailed standards for Human Resources and Social Security authorities to implement administrative penalties under Shenzhen's existing sex equality regulations. Shenzhen's existing sex equality regulations were the first local regulations in China to exclusively address the issue of sex equality. Please see our August 2012 and February 2014 newsletters for a full discussion of the regulations.

According to the notice, any employer imposing sex-based hiring restrictions during the recruitment process will be fined CNY 3,000 if the employer fails to remove the restriction within the timeline set by the labor bureau. In addition, refusing to hire female candidates or setting higher job qualification standards based on an individual's sex, marriage status or pregnancy status will also

result in fines ranging from CNY 10,000 to CNY 30,000 depending on the number of candidates harmed.

Jiangsu Province

On 1 July 2018, the *Special Provisions of Jiangsu Province for Labor Protection of Female Employees* superseded the 1989 measures on the same subject. The provisions add new requirements on sex-neutral hiring and prohibit employers from restricting, refusing or setting higher job qualification standards for hiring female employees. Moreover, the employment contract with a female employee may not restrict her right to marriage and childbirth.

In addition, the provisions specifically require employers to take certain steps to prevent sexual harassment, such as: formulating anti-sexual harassment workplace policies; providing training to employees on sexual harassment; and establishing an employee complaint channel, handling complaints in a timely manner, and protecting the privacy of the parties involved.

In terms of employee protections related to childbirth, the provisions address and clarify several key issues on maternity leave, nursing leave and other related benefits. First, the provisions include more generous miscarriage leave than under national law. Second, the provisions include greater rest entitlement and working hour restrictions for employees in their first and last trimesters of pregnancy. Finally, after an employee's maternity leave period ends, the employee may take up to six months of nursing leave with employer approval at 80% of her base salary. If the employee would like to take nursing leave beyond six months, the employer and employee can negotiate the adjusted salary.

Key takeaway points:

Local governments in China are enhancing protections for female employees. Employers should stay informed about these latest developments and update their policies, procedures and employment contracts as necessary to comply with local laws and regulations.

Guangdong Province provides guidance on labor disputes

On 18 July 2018, the Guangdong Province High People's Court and Arbitration Committee jointly issued *Several Opinions on Coordination Between Labor Arbitration and Litigation*. The opinion took effect on the same day.

Key highlights from the opinion include:

- *Severance payment calculations for pre-2008 service years should follow Employment Contract Law*. With the recent repeal of the national *Measures for Economic Compensation for Breach and Termination of Employment Contracts* (for details, please see our December 2017 newsletter), employers have been uncertain about how to calculate severance for pre-2008 service years. The Guangdong opinions state that employers should follow local regulations in effect before 1 January 2008 to determine whether an employee is even entitled to severance for pre-2008 service years. More importantly, however, the opinion states

that when calculating severance for employees who are so entitled, the employer should follow the PRC Employment Contract Law to calculate the severance for an employee's pre-2008 service years.

When calculating severance for pre-2008 service years, employers should note the following:

- Salary base for severance. Normally, severance is calculated at one month's "average monthly salary during the last calendar year" for each full year of service with the employer. If an employee's average monthly salary exceeds 300% of the local municipal average monthly salary, then the employee's salary base for severance will be capped at 300% of the local municipal average monthly salary. Additionally, when the employee's salary base for severance is capped, the employer can also cap the employee's service years at 12 years. This cap on service years is likely a cumulative cap on both pre-2008 and post-2008 service years together. In comparison, before the Guangdong opinions, in certain situations, e.g., mutual separation, the employee's pre-2008 and post-2008 service years were subject to separate 12-year caps.

- Partial service years. Less than six months of service during a calendar year entitles the employee to severance equal to a half month's "average monthly salary" for that partial service year. In comparison, six months or more of service in a calendar year is considered a full service year for severance calculation purposes, entitling the employee to one month's average monthly salary as severance for that service year. Prior to this opinion, certain courts referred to pre-2008 local regulations when determining how to treat partial years of service.

- *Dispatch employees are entitled to open-term contracts.* Dispatch employees in Guangdong are entitled to sign an open-term employment contract if they have signed two consecutive employment contracts after 1 January 2008 or have worked for the same employer for 10 years. In other words, their entitlement to an open-term contract would be the same as enjoyed by directly-hired employees.

- *Unilateral terminations allowed when employer suspends operations.* An employer may terminate employees based on Article 40.3 of the Employment Contract Law, i.e., a major change in objective circumstances rendering continued performance of the employment contract impossible, if the employer suspends its operations because it suffers serious financial difficulties for reasons not attributable to the employees and may lose the ability to pay debts. Before the Guangdong opinions, termination on these grounds was normally limited to company restructurings.

  Alternatively, instead of unilaterally terminating employees, the employer can negotiate with the employees for a set suspension period during which the employees will not be terminated and will not work. During the first month of suspension, the employees must be paid full salary. Starting from the second month of the suspension, the employees must be paid no lower than 80% of the local minimum wage. If the suspension exceeds the "reasonable standard" or the agreed upon term, the

employees may terminate their employment contracts and claim severance. The Guangdong opinions do not define or further explain the meaning of "reasonable standard."

In addition to these key highlights, the Guangdong opinions also provide further guidance on other important issues, e.g., how to calculate wages and salary for employees on maternity, paternity and work injury leave.

Key takeaway points:

The Guangdong opinions address several controversial labor dispute issues. Employers in Guangdong Province should familiarize themselves with the opinions before handling any future labor disputes. In particular, employers should ensure they correctly determine severance eligibility for pre-2008 service years by following local rules in effect before 1 January 2008 and correctly calculate the severance for those years by following the Employment Contract Law.

Tianjin issues implementing measures for Employment Contract Law

On 2 July 2018, the Tianjin Municipal Human Resources and Social Security Bureau issued the *Implementing Measures on Several Issues Concerning the Employment Contract Law*, effective on 1 August 2018. The implementing measures apply to all companies in Tianjin when establishing, amending or terminating employment contracts.

Key highlights from the implementing measures include:

- *Employment establishment*: If an employee attends any employer-scheduled job training prior to the employee's first day on the job, then the employment relationship between the employee and the employer is deemed to have been established on the day the employee attends the training.

- *Job position adjustment*: The implementing measures permit an employer to unilaterally adjust an employee's job position if permitted by the employment contract or company policy. However, the unilateral adjustment must: (i) be objectively required for company operations; (ii) maintain the employee's salary level for any position adjustment other than in cases where adjustment is due to employee poor performance or being unable to perform the original work due to illness or injury; (iii) be non-discriminatory; and (iv) comply with the law.

- *Serious violation of company rules and regulations*: If the employer has not **expressly** stipulated in its written rules and regulations the specific conduct that will constitute a serious violation leading to termination, then the employer cannot terminate the employee for that misconduct as a serious violation of company rules.

- *Termination timing*: An employer has six months from the date the employer knows or should have known an employee has engaged in serious misconduct to terminate the employee's employment contract for that act. Those acts include serious violations of company rules, serious dereliction of duty, criminal behavior, etc.

Key takeaway points:

Employers in Tianjin should ensure their compliance with the new measures. They should review and amend their employment contracts and other policies as necessary, especially to address the rules on termination for serious violation of company rules and regulations and adjustment to an employee's position. When conducting investigations of misconduct, companies should also keep the termination timing requirement in mind.

Tianjin implements new alternative working hours regulations

On 29 April 2018, the Tianjin Municipal Human Resources and Social Security Bureau published and implemented the *Measures on Administrative Permits for Alternative Working Hours Systems*. Under the measures, employers need approval from the local human resources and social security bureaus to implement an alternative working hours system. Once approved, the employer's alternative working hours approval is generally valid for two years.

When implementing an alternative working hours system for employees, employers should pay attention to some key issues under the Tianjin measures.

First, the Tianjin measures state that the overtime exemption in national rules for employees working under the flexible working hours system does not apply to those employees when working on a national public holiday. Those employees must be paid overtime at the statutory 300% rate for work on a national public holiday.

Second, if a host company requires an alternative working hours system for job positions filled by labor dispatch workers, the host company rather than the labor dispatch agency should apply to implement the alternative working hours system. The host company should inform the labor dispatch agency about the application, because the labor dispatch agency is the employer of the dispatch workers who will be subject to the alternative working hours system.

Finally, employees working under the comprehensive working hours system may not work more than 14 hours per day. Additionally, for round-the-clock operations, employers must implement a shift work system. But the employer cannot cover the 24-hour work day using only two 12-hour shifts even if the employees are subject to the comprehensive working hours system.

Key takeaway points:

Tianjin's approach to requiring overtime pay on national public holidays covers both employees working under the comprehensive working hours system and employees working under the flexible working hours system. While national regulations require overtime pay to employees working under the comprehensive working hours system, Tianjin is part of a new trend in also requiring it for employees working under the flexible working hours system.

The Tianjin measures protect employee rights to rest even if those employees work under an alternative working hours system. In particular,

employers must arrange reasonable rest time for employees working under the comprehensive working hours system by following the maximum working hours per day and by eliminating the "two-shift work schedule" to prevent employees from being overworked during the employer's busy season.

Highest court in Jiangsu Province rejects employee severance claim for failure to make social insurance contributions

In March 2018, the High People's Court of Jiangsu Province rejected an employee's severance claim for the employer's failure to make social insurance contributions on the employee's behalf. The employer did not make the social insurance contributions because the employee signed a letter of commitment with the employer to acknowledge his unwillingness to make social insurance contributions due to his own reasons.

In January 2014, the employee signed a letter of commitment stating both his unwillingness to make social insurance contributions and his willingness to bear all financial losses and legal liabilities arising from the employer not making the social insurance contributions on his behalf. In addition, the employee waived any claims against the employer in relation to the unpaid social insurance contributions. Later, the employee sued the employer for failing to make social insurance contributions on his behalf.

The court held that the letter of commitment showed the employee's true intent absent any evidence proving the employee had been coerced by the employer into signing the letter. Moreover, since the employee in the letter waived all claims against the employer for the unpaid social insurance contributions, the employee could not claim severance payment on the grounds that the employer failed to make social insurance on his behalf.

Key takeaway points:

Although the employee's letter of commitment was enforced in this case in relation to the severance claim, most courts, tribunals and administrative authorities do not enforce such agreements to not pay social insurance. In particular, these commitments cannot be used as a defence against an administrative order requiring employers to pay unpaid or underpaid social insurance contributions. Therefore, employers should make social insurance contributions for employees in accordance with the law and should not enter into these social insurance non-payment commitments even at the request of their employees.

Highest court in Hunan Province sets model for calculating damages in criminal employee trade secret theft case

Recently, the Hunan Province High People's Court announced 10 model cases on IP related litigation.

In one model case, two former employees criminally misappropriated their former employer's trade secrets to manufacture competing products. The Changsha Yuelu district court adopted a damages calculation method normally used in civil IP litigation. The court adopted this civil litigation

calculation method because the criminal law and applicable judicial interpretations lacked a corresponding calculation method.

The court calculated the trade secret rights holder's damages as:

> ***Damages*** = ***sales volume*** *(calculated based on the copycat products sold by infringer's company) X* ***reasonable profit of trade secret rights holder on the product*** **–** ***estimated period costs incurred by trade secret rights holder***

Under this calculation, "reasonable profit" equals the minimum sales price for the genuine product sold by the trade secret rights holder multiplied by the estimated profit rate. The "estimated profit rate" is calculated based on the trade secret rights holder's profit on sales of the genuine products in the same volume as the infringer's sales volume.

Using this calculation method, the court estimated damages at CNY 2.99 million. Based on this estimate, the court ordered each defendant to serve a three-year prison sentence and fined the defendants based on their level of culpability.

Key takeaway points:

This case shows that courts can be flexible in determining a victim's damages in a criminal employee trade secret misappropriation case. By using the trade secret rights holder's reasonable profits to determine the damages, the court was better able to protect the trade secret rights holder's interests.

Courts order significant amount of damages for breach of post-termination non-compete restrictions

Recently, courts have shown a willingness to award significant damages in high profile non-compete cases, including upholding liquidated damages clauses that impose high level penalties for breach. For example, the Shanghai No. 1 People's Court reportedly ordered an R&D employee to pay CNY 19.4 million to his former employer for breaching his post-termination non-compete obligations. Other courts upheld liquidated damages of approximately 10 times the amount of the non-compete compensation received by the employees from their prior employers.

In the Shanghai case, the employee was hired to engage in online gaming R&D operations and had access to material information of the company. He received restricted stock options from the company to sign a confidentiality and non-compete agreement. Under the agreement, the employee agreed to not work in the same or similar industry as his employer for a set post-termination period upon separating from the company. In addition to the stock options, the employer agreed to pay the employee additional non-compete compensation for the post-termination non-compete period.

While still employed with the company, the employee established a tech company. After separating from the company, but still during the post-termination non-compete period, the employee established two more tech companies. In the final ruling, the appellate court ordered the employee to pay CNY 19.4 million in damages, which was significantly higher than the 3.72 million in damages that was originally awarded by the first instance

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court. The appellate court took into consideration the restricted stock benefit that was provided to the employee when making the decision on the damages amount.

In another set of cases, a Chinese search engine company reportedly brought a series of suits against former employees who joined a map search engine company (or the subsidiary of that map search engine company) during their post-termination non-compete term. In each of the cases, the final court ruling ordered the former employees to refund the non-compete compensation received from their prior employer and to pay additional liquidated damages of approximately 10 times the amount of the non-compete compensation received from their prior employer in accordance with the contractually stipulated liquidated damages amount.

Key takeaway points:

PRC courts have recently shown their willingness to protect employers and award high damages amounts when former employees breach non-compete obligations. As the search engine cases show, employers should include liquidated damages clauses in their non-compete agreements, and set them at appropriately high levels to ensure the company is appropriately compensated for any damages, as the courts are becoming more willing to uphold liquidated damages penalties set at a high amount.

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