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China Employment Law Update

Newsletter

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China takes further steps to reduce social insurance burden on employers

China is further reducing social insurance burdens on employers according to a national notice and its implementing rules issued in April 2019. On 1 April 2019, the State Council issued the notice on *Comprehensive Plans for Reducing Social Insurance Contributions*. On 28 April 2019, implementing rules in support of the notice were jointly issued by the Ministry of Human Resources and Social Security, the Ministry of Finance, the State Taxation Administration, and the National Healthcare Security Administration.

The notice and its implementing rules will:

1. **Reduce pension contributions by employers:** Starting from 1 May 2019, China has reduced the maximum employer contribution rate for pension insurance from 20% to 16%. This reduction was first introduced by the Ministry of Finance in March and is being restated in the notice and its implementing rules. Please see our March newsletter discussing the reduction.

2. **Continue with temporary reductions in employer contributions to unemployment insurance and work injury insurance**: These temporary reductions will remain in effect until 30 April 2020.

3. **Discourage large back-payment orders against companies that have past social insurance non-compliance**: The notice and its implementing rules specifically require local authorities to take actions to substantially reduce social insurance burdens on small-scale employers, and recommend that they do not impose large back payment orders on companies that previously underpaid or did not pay social insurance contributions.

4. **Reduce social insurance contributions by adjusting the calculation formula for the base amount**: Social insurance contributions are generally calculated based on an individual employee's average monthly salary from the previous year ("**base amount**"), with caps and floors for the base amount determined at the local level. The notice stipulates that the formula used for determining the caps and floors on the base amount should be adjusted downwards so that ultimately the contribution amounts payable would be less.

Key take-away points:

These policies reveal the government's commitment to reducing the social insurance burden on employers, likely due to concerns about a slowing economy. Employers should review these newly issued policies and any forthcoming national and local policies to ensure they are making the correct social insurance contributions.

Notice pushes for the establishment of communist party organizations within companies

In May 2019, the General Office of the CPC Central Committee circulated a notice requiring the further establishment of communist party organizations at the grassroots level. The notice also pushes for, but does not expressly require, that these communist party organizations be established directly within companies.

The notice emphasizes the urgency and importance of establishing communist party organizations at the grassroots level. Among other things, the notice requires communist party organizations to extend their coverage to new areas. The notice does not include a definition for the "new areas" to be covered. But it does expressly mention the internet industry as an example.

The notice provides that communist party organizations will first be established within industries and within various industrial parks. From there, these organizations will push companies within the industry and within the industrial parks to establish communist party organizations within the companies themselves.

Key take-away points:

The notice does not directly impose any obligation on companies to immediately establish communist party organizations. However, the notice indicates that the General Office of the CPC Central Committee or the grassroots communist party organizations may take further actions to spur companies to establish communist party organizations in the near future. Thus, companies should monitor how these grassroots communist party organizations establish themselves and whether and in what manner they "take further actions" to push for companies to establish communist party organizations.

New measures to enhance coordination between authorities handling production safety crimes

On 16 April 2019, the Ministry of Emergency Management, the Ministry of Public Security, the Supreme Court and the Supreme Procuratorate jointly issued the *Measures on Coordination Between Administrative Enforcement and Criminal Proceedings in Production Safety Crimes*.

The measures aim to strengthen the coordination between various authorities when responding to production safety incidents and when prosecuting production safety crimes. The measures apply to serious production safety crimes, such as forcing employees to work in dangerous conditions, major work safety accidents, and accidents involving hazardous substances.

The measures aim to strengthen coordination between various authorities in daily supervision, accident investigation, consultation in complicated cases, and criminal prosecution. For example, the measures address how to transfer a case from the emergency management authorities to the pubic security authorities, and further to the procuratorates (i.e., prosecutors), who will then

decide whether to prosecute. Furthermore, the procuratorates and courts may issue remedial orders if they identify major production safety issues in a company's production processes or identify violations by the government authorities in handling production accidents.

In addition, the measures also aim to establish a regular coordination mechanism between different authorities so that they can review and draw lessons from production safety accidents and crimes. Emergency management authorities, public security authorities, procuratorates and courts will regularly convene to discuss major production safety cases and jointly publicize key information on handling them.

Key take-away points:

The measures reflect the importance that the government is placing on production safety issues. Every company with manufacturing functions in China should devote attention and resources to production safety and should follow applicable safety laws to prevent accidents and avoid non-compliance penalties.

CAC issues two draft measures on transferring important data and personal information overseas

To support the implementation of the China Cybersecurity Law, the Cyberspace Administration of China (CAC) published the draft *Measures for the Administration of Data Security* ("**Draft Data Security Measures**") on 28 May 2019 and the draft *Measures for Security Assessment on the Export of Personal Information* ("**Draft Security Assessment Measures**") on 13 June 2019. The CAC is soliciting public comments on the drafts until 28 June 2019 and 13 July 2019 respectively.

With these two drafts, the CAC seems to be proposing separate requirements for transfers of important data and for transfers of personal information. Network operators will need to follow a different set of security assessment procedures when transferring these different types of information out of China.

Transferring important data overseas

"Important data" can be broadly defined as data that if leaked, may directly impact national security, economic security, social stability or public health and safety.

Under the Draft Data Security Measures, network operators intending to transfer important data overseas must conduct a security assessment and obtain approval from the competent industry regulator or the provincial counterpart of the CAC.

Transferring personal information overseas

"Personal information" can be broadly defined as information that by itself or in combination with other information can be used to identify a person or their birthdate, identification number, physical data, address, phone number, etc.

Under the Draft Security Assessment Measures, network operators intending to transfer personal information overseas must:

1. enter into a contract or other form of legally binding document with the foreign recipient of the personal information to be transferred out of China

2. conduct a self-assessment of the security risks associated with the intended transfer and the security safeguards and measures adopted to address those risks

3. prepare a security assessment report.

The contract with the foreign recipient must include:

- the purpose for transferring the personal information, the information type and the information retention period

- the rights and interests of the data subjects

- the remedies available to data subjects for the infringement of their rights and interests

- the contract termination or the trigger of a new security assessment upon any change in the foreign data recipient's ability to perform the contract

- the stipulation that the responsibilities and obligations of the network operator and the foreign data recipient survive the termination of the contract.

After conducting the self-assessment and preparing the security assessment report, the network operator may submit the security assessment report and other supporting documents to the CAC for its security assessment review of the proposed transfer of personal information. Unlike the CAC's previous draft measures, the Draft Security Assessment Measures require **all** transfers of personal information from network operators in China to foreign data recipients to undergo the security self-assessment and CAC security assessment review. This two-step security assessment process also applies to information collected in China by overseas institutions as well. See our M&A group's June alert on the Draft Security Assessment Measures for more details on the requirements for overseas institutions collecting information in China.

Key take-away points:

The security assessment formalities introduced by the Draft Security Assessment Measures could create cumbersome administrative and operational burdens for companies. In particular, it could pose high operational challenges both to Chinese domestic companies conducting international business or communicating with overseas counterparties and to foreign-invested companies sharing personal information, such as employee personal information, with overseas parents and affiliates on a daily basis.

However, it currently remains unclear whether the two draft measures would actually apply to employee personal information shared during the normal course of business operations. Employers should monitor how the two draft measures are finalized and interpreted during their implementation.

Beijing district court holds conference to comment on workplace sexual harassment

On 7 March 2019, the Beijing Xicheng District People's Court convened a live online judicial conference to review typical labor cases involving workplace sexual harassment and to suggest companies take proactive measures to prevent workplace sexual harassment.

As part of an overview of legal issues relating to workplace sexual harassment, the conference discussed two workplace sexual harassment cases: the first to emphasize the importance of collecting evidence, particularly confessions; the second to emphasize the importance of having a company policy specifying sexual harassment as serious misconduct warranting summary dismissal.

In the first case, an internet company unlawfully terminated a male finance manager for allegedly insulting and sexually harassing a female subordinate. The termination was ruled unlawful because the company provided insufficient evidence to prove the employee's misconduct. The company only provided the victim's testimony and a recorded interview in which the employee denied the victim's allegations. When discussing the case, the judges explained that employers are at risk of losing termination cases if they fail to present the employee's confession or other sufficient evidence to prove the sexual harassment occurred.

In the second case, a property management company lawfully terminated a male employee for seriously breaching company rules by sexually harassing female colleagues. The employee confessed to the conduct during company and police interviews. Based on this confession, the company terminated the employee under its company policy that sexual harassment was serious misconduct warranting summary dismissal. When discussing the case, the judges emphasized the importance of having a company policy expressly prohibiting sexual harassment as serious misconduct so that companies can summarily dismiss offenders.

Finally, the conference made some general recommendations. It recommended companies establish investigation procedures and provide sexual harassment training to employees. And it summarized the major measures that companies should take to prevent workplace sexual harassment and to justify termination for sexual harassment.

Key take-away points:

Terminating employees for workplace sexual harassment involves high risks of wrongful termination. As reflected by the cases discussed at the conference, the most important evidence will always be a confession. Nonetheless, if a confession cannot be obtained, the employer should gather other forms of evidence, such as photographs, videos or recordings, that may have captured the conduct.

Employers should also ensure their company rules allow them to terminate sexual harassers on the statutory ground of "serious breach of company rules". Therefore, company rules should list sexual harassment as serious misconduct warranting summary dismissal.

Beijing court rejects employer's claw back claim of CNY 9 million in non-compete compensation

The Beijing No. 2 Intermediate People's Court recently denied an employer's claim demanding a former employee repay CNY 9 million in non-compete compensation and pay CNY 2.7 million in liquated damages for breach of a non-compete obligation. The court denied recovery because the employer had presented insufficient evidence of actual competition between itself and the employee's companies.

In January 2013, the employee joined the employer's company as vice president and general counsel. Sometime after joining the company, the employee established three companies and accepted a directorship in a fourth company while still employed by the employer. All four companies had a similar or an overlapping business scope with the employer's company.

In November 2015, the employee signed two agreements with the employer. First, the employee signed a confidentiality, IP and non-compete agreement to generally restrict the employee for two years from engaging in competitive behavior, such as establishing a competing business or working for a competitor, once the employee's employment ended. At the time of signing the agreement, the employer was still unaware of the employee's activities with the other four companies. Second, when being awarded a CNY 9 million bonus for contributions made to the company, the employee signed an agreement that the CNY 9 million was actually non-compete compensation for the two-year non-compete restriction in the first agreement.

In April 2016, the employee left the employer's company and continued the activities with the other four companies. At this point, the employer learned about the employee's relationship with the four companies and brought a lawsuit to enforce the non-compete restriction signed by the employee.

The court examined two issues in the case. First, the court ruled for the employer by deciding the agreement identifying the CNY 9 million as non-compete compensation was legal and valid. Second, the court ruled against the employer by deciding there was insufficient evidence showing the employer's company and the employee's companies were competitors. The court ruled in this way on the second issue because the employer had only presented evidence that the business scopes registered by the other four companies were similar or overlapping with the employer's business scope. The court felt this evidence was insufficient to establish that the four companies were actually competitors with the employer's company. As such, the judge denied the employer's claim to recover the non-compete compensation and to receive liquidated damages.

On appeal, the second instance court affirmed the first instance court's judgment.

Key take-away points:

To support a claim for breach of a non-competition agreement, Beijing courts may require more substantial evidence of actual competition between businesses than companies merely having similar or overlapping registered business scopes. Therefore, companies should collect evidence of actual operational competition before bringing a claim for breach. To find this evidence, a company can, for example, review the competitor company's

website for product introductions and monitor media reports for news about the competitor company engaging in events or business activities that demonstrate actual operational competition.

Shanghai court allows employer to cancel employee's CNY 1.2 million deferred bonus

In February, the Shanghai First Intermediate People's Court ruled that an employer could cancel an announced but unpaid deferred bonus of CNY 1.2 million to a senior fund manager because the bonus was not fixed compensation and was subject to conditions in the company's bonus policy and a special agreement with the employee.

The employee joined the company in 2007 and became the company's general manager in 2011. Later, the employee also became the company's legal representative and head of the compensation committee.

In 2015, after approval by the employee, the company issued its compensation plan for 2015 to 2017. According to the plan, for mid-level managers and above, 70% of their performance bonus would be paid in the year of performance, and the remaining 30% would be paid in the next year as a deferred bonus. If the employee were to leave the company during the performance period, the employee would voluntarily relinquish the bonus for the current performance period and would be ineligible for the deferred bonus for the previous performance period.

This compensation plan language was similar to performance bonus language contained in a job position agreement signed between the employee and the company in 2014. That agreement also contained clauses stating that the company had explained the meaning of the agreement's terms to the employee and that the employee had understood all the terms. The agreement was effective through 10 October 2017.

On 28 April 2017, the employee resigned. The company refused to pay the CNY 1.2 million deferred bonus for 2016. The employee filed a labor arbitration claim to recover the deferred bonus. The case eventually escalated to Shanghai's First Intermediate People's Court.

The court rejected the employee's claim for the deferred bonus by reasoning that the performance bonus was not fixed compensation and was subject to the company's bonus policy and special agreement with the employee.

Key take-away points:

Courts often respect a company's right to formulate its own bonus payment conditions because bonus compensation is generally considered additional compensation that the company voluntarily awards to its employees. To retain the flexibility to disqualify an employee from a performance bonus after the bonus amount has been decided but before the bonus payment has been made, the company should clearly express the bonus disqualification rules in writing and communicate those rules to employees. However, even with such language, there is no guarantee that all courts would uphold such a cancellation.

Employees convicted for copying source code from their employer's apps

Four employees were fined and imprisoned for criminal infringement of their employer's trade secrets for copying the source code from their employer's apps.

Located in Beijing, the employer developed and provided mobile software, including a cache clean-up app. The four employees provided product design, technology development and business development for the cache clean-up app and for other of the employer's software products. They signed confidentiality and non-compete clauses as part of their employment contracts. During their employment, the four employees conspired together and used the employer's source code, business operations data and marketing strategy to develop a mobile app with a cache clean-up function. The four employees resigned their employment to establish their own business providing the app.

The employer noticed that the main business, software source code and client base of the company established by the four former employees were all remarkably similar to its own. The employer filed a case with the Guangzhou Public Security Bureau accusing the four former employees of infringing on the employer's trade secrets. Upon investigating, the public security bureau identified at least 67 instances in the app's source code that were the same or were substantially similar to the source code in the employer's apps. This source code was technological information that was unknown to the public.

Based on this evidence, the court ruled that the four individuals were guilty of infringing the employer's trade secrets. Each of them was sentenced to two years in prison and fined from CNY 150,000 to CNY 200,000. Their illegal earnings of CNY 680,000 were also confiscated.

Key take-away points:

This case shows that it is sometimes possible to pursue ex-employees for criminal liability for theft of trade secrets, though gathering sufficient evidence is still generally difficult. To ensure trade secret protections, every employer should conclude a confidentiality agreement or include confidentiality clauses in its employment contract with any employee who has access to the employer's trade secrets. The confidentiality obligations should explicitly extend after employment ends.

Chengdu court rules termination unlawful when employees fired for not reporting to new work locations

In two recent cases, the Chengdu Intermediate Court ruled that employers unlawfully terminated employees for not reporting to adjusted job positions that required the employees to work from locations unreasonably distant from their original work locations.

In the first case, the employer required a sales employee originally assigned to its Qingbaijiang district store to work from its Wuhou district store while stores were being renovated. As the employee lived in Qingbaijiang district, it

would have taken the employee an additional three hours to commute between the employee's home and the Wuhou district store. The employee refused to report to work at the Wuhou district store and continued to work from the Qingbaijiang district store. The employer deemed the employee's failure to report to work at the new store as an unauthorized absence, which was a serious violation of the company's rules, and thus summarily dismissed the employee.

The court held that although the employment contract allowed the employer to require the employee to work from another location, the location change must be reasonable. Even with the shuttle bus provided by the employer to cover the travel between the two districts within Chengdu municipality, the three-hour increase in commute time was not a reasonable adjustment to impose on the employee. Moreover, since the employee continued to work at the original store, the employee's failure to report to work at the new store could not be deemed as an absence. Therefore, the court ruled that the employer's termination was unlawful and ordered the employer to pay double severance to the employee for the unlawful termination.

In the second case, the employee signed an employment contract to work in an office management position in Chengdu. After the contract was signed, the employer announced an open competition among all employees for management positions. The announcement also said that if an employee was not selected for a management position, the employer would assign the employee to work in the field on new projects.

The employee who had signed the employment contract for a Chengdu office management position was not selected for an office management position through the competition. The employer sent a position adjustment notice assigning the employee to work on a project in Liangshan Autonomous Prefecture, which is about 340 km from Chengdu. The employee not only refused to report to the new position but also did not report to work in Chengdu while negotiating with the employer about the adjustment. The employer summarily dismissed the employee for the unauthorized absence from work.

First, the court ruled that despite the employee's participation in the open competition, the employee never consented to being assigned to another position because the employee was forced to compete. Second, the court ruled that the new work location was unreasonably distant from the contract work location and was thus not aligned with the employee's intent in the employment contract. Finally, as the employee had continued negotiating with the employer while not reporting for work, the court ruled that the absence from work could not be deemed as an unauthorized absence. Based on these arguments, the court ruled that the employee was unlawfully terminated.

Key take-away points:

Any unilateral work location change should not lead to a significant increase in commute time, even if the employment contract gives the company discretion to adjust an employee's work location. According to the Chengdu cases, an increase in commute time by a few hours may be deemed unreasonable even if the new location is still within the same city and the employer assists the employee with transportation, e.g., providing a shuttle bus. The employer will be exposed to an unlawful termination lawsuit by

terminating the employee for an unauthorized absence from work for the employee's refusal to report to an unreasonably distant work location.

Wuxi court rules employee lawfully terminated for harming employer's reputation

Recently, the Wuxi Intermediate Court ruled that an employee was lawfully terminated for inviting 40 commercial tenants under the employee's management to a birthday party for the employee's child. The court considered the action to be a serious violation of a policy in the employee handbook prohibiting employees from harming the company's reputation.

The employee was a manager at a property management company servicing a large shopping mall. The employee sent birthday invitations to 40 tenants that were under the direct management of the employee's department. Some tenants felt the birthday invitations were a method to solicit bribes because the tenants had no personal relationship with employee. These tenants jointly reported the employee to the company.

The company's auditing department concluded that the employee's behavior had harmed the company's reputation and that the employee should thus be unilaterally terminated according to the employee handbook. The recommendation for unilateral termination was discussed and passed in an employee representative meeting. The company also notified the company union. After these steps, the company unilaterally terminated the employee. The company union later agreed to the termination in writing.

The employee sued the company for wrongful termination and claimed severance pay. The employee argued that invitations were sent but no bribes were received; therefore, the behaviour should not have been regarded as soliciting bribes. According to this argument, since the employee had not solicited bribes, there was no serious violation of company policy. As such, the company did not have valid grounds to terminate.

In response, the company argued that the employee's behavior constituted grounds for unilateral termination as covered by Article 6 in the company's employee handbook. Article 6 provided that an employee who "seriously impairs the company's reputation and benefits" may be unilaterally terminated by the company. Although the report was unclear in recounting the company's exact argument, it appears the company argued that the employee had harmed the company's reputation as soon as the tenants read birthday invitations perceived as soliciting bribes, regardless of whether those invitations were genuine or whether no bribes were received. Moreover, the company provided evidence to prove that the company's employee handbook was adopted through an employee consultation process and thus could be used as valid grounds for termination.

The court sided with the company that the employee's behavior constituted lawful grounds for unilateral termination covered by Article 6 of the company's employee handbook. The court also agreed that the company's employee handbook was properly established and thus could be used as valid grounds for termination.

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Band 1 Law Firm for Employment: PRC Law – *Chambers Asia Pacific, 2009 - 2018*

International Firm of the Year: Labour & Employment – *China Law & Practice Awards, 2018, 2015 & 2011*

In-house Community Employment Firm of the Year (China) – *Asian-MENA Counsel Representing Corporate Asia & Middle East Survey 2016*

Honourable Mention: In-house Community Employment Firm of the Year (Hong Kong) – *Asian-MENA Counsel Representing Corporate Asia & Middle East Survey, 2015*

Honourable Mention: In-house Community Employment Firm of the Year (China) – *Asian-MENA Counsel Representing Corporate Asia & Middle East Survey, 2014*

Winning Law Firm for Employment & Labour – *China Business Law Journal, China Business Law Awards, 2016*

Key take-away points:

This case shows that general clauses authorizing unilateral termination for an employee who "seriously impairs the company's reputation and benefits" can cover unforeseen employee behavior harming the company. Still, as a best practice, unilateral termination policies should list as many specific termination grounds as possible.

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