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Ten Frequently Asked Questions about China's Labor Law

With the explosive growth of the Chinese economy, many companies are opening offices in China. Hiring employees in China requires a detailed understanding of local laws and regulations. Ying Li and Lijuan Hou of Proskauer's Hong Kong office have compiled this list of ten frequently asked questions about the laws affecting foreign employers opening offices in the People's Republic of China.

1. How can foreign-invested entities in the PRC hire PRC individuals?

There are three types of commonly used foreign investment vehicles in the People's Republic of China ("PRC"), which are: wholly foreign owned enterprises ("WFOEs"), Sino-foreign joint ventures ("JVs"), and foreign enterprises' representative offices ("Rep Offices"). WFOEs and JVs, as PRC-incorporated companies, can hire PRC individuals directly. Rep Offices are not independent PRC legal entities and are merely offices representing their foreign parents. Rep Offices are not permitted by PRC law to hire PRC individuals directly. Instead, they have to hire PRC individuals indirectly through PRC-licensed labor agents (e.g., FESCO and CIIC). The labor agent will be the nominal employer of the PRC individuals hired for the Rep Office, and it will dispatch such PRC individuals to the Rep Office to provide employment services.

The relationship between the labor agent and the Rep Office is typically governed by a service agreement, including an indemnification arrangement under which the labor agent's obligations and liabilities as an employer are assumed by the Rep Office.

2. Are employers required by PRC law to sign written employment contracts with their PRC employees?

Yes, under PRC law, employers must sign written employment contracts with their PRC employees (except for those part-time employees who are normally paid on an hourly basis; in which case, their employment contracts could be oral). As a good practice, it is recommended that an employer sign a written contract with its PRC employees before commencement of employment, though the minimum requirement set by PRC law is to have the written contract signed within one month after the employee starts work. An employer who fails to meet this deadline will be required, during the first year of employment, to pay double salary to the employee from the second month of employment until the contract is signed (unless the delay is due to the employee's delay or refusal to sign the contract). After one full year of employment, if the employer still fails to sign a written employment contract, it will be deemed to have concluded an open-term employment contract with the employee, which is very difficult to terminate.

3. Does PRC law permit at-will employment? If not, does an employment contract need to have a specified term?

At-will employment is not permitted by PRC law. Under PRC law, employees have the right to terminate an employment contract without cause by giving written notice, while employers are not granted the same right. Employers can only terminate employment contracts based on limited grounds expressly provided under PRC law (discussed below).

Except for project-based contracts set to expire upon the completion of certain tasks, an employment contract under PRC law will be either one with a fixed term or one with an open term. Because open-term contracts are difficult to terminate, employers are generally advised to enter into fixed-term employment contracts. Under certain circumstances specified in PRC labor laws and regulations, an open-term contract is required, unless the employee expressly gives up that entitlement. These circumstances mainly include (i) where an employer fails to sign a written employment contract within one year after the employee commences work (as mentioned above); (ii) where a fixed-term employment contract has been renewed twice and is going to be renewed for the third time; and (iii) where an employee has continuously worked for the same employer for 10 years or more.

4. Can employers set a probation period in an employment contract? If so, how long can the probation period be?

An employer is allowed to set a probation period for the employee in the contract. Under PRC law, the probation period for a contract with a term between three months and one year may not exceed one month, the probation period for a contract with a term between one year and three years may not exceed two months, and the probation period for a contract of more than three years or an open-term contract may not exceed six months. It is easier to terminate an employee during the probation period, but PRC law still requires certain legal causes for termination.

5. Are employers required to pay overtime to their employees under PRC law? How is overtime pay calculated?

Under PRC law, the employee's right to overtime pay is directly related to the work hours regime under which he is employed. There are three types of work hours regimes in the PRC: standard work hours, flexible work hours and comprehensively calculated work hours. Standard work hours (i.e., 8 hours per day and 40 hours per week) applies automatically to all PRC employees unless special approval has been obtained for application of a flexible or comprehensively calculated arrangement. Under the standard work hours regime, overtime pay will need to be paid if an employee is required to work outside of normal business working hours. The overtime pay rate provided by PRC law is 1.5 times the regular rate of pay for overtime work on normal business days, double-time for weekend overtime work, and triple time for work on public holidays.

Employers can obtain approval from local labor authorities for a flexible or comprehensively calculated work arrangement for employees who are unable to follow the standard regime due to the nature of their jobs or industries. To obtain such approval, an employer will be required to submit a relatively detailed proposal for the work hours and rest schedule applicable to the employees to be covered. Overtime pay will then be required for work outside the approved schedule.

6. How many holidays is an employee entitled to under PRC law?

In the PRC, there are seven statutory public holidays, totaling eleven days: New Year Holiday (1 day), Spring Festival Holiday (3 days), Qingming Festival Holiday (1 day), Labor Day Holiday (1 day), Dragon Boat Festival Holiday (1 day), Mid-Autumn Festival Holiday (1 day) and National Day Holiday (3 days). Moreover, as a traditional practice, weekday holidays are often combined with weekends to form a longer holiday. For example, for a one-day statutory holiday, the government moves one adjacent weekend (if necessary) to create a three-day vacation period; if there is a three-day statutory holiday, the government moves two adjacent weekends (if necessary) to create a seven-day vacation period.

In addition to public holidays, an employee who has worked for a continuous period of twelve months (this twelve-month period of continuous employment includes employment with any employer, not just the current employer) also will be entitled to certain days of statutory paid leave each year under PRC law, the length of which will depend on his/her cumulative service period (with any employer). Specifically, an employee with a cumulative service period between one year and ten years will be entitled to five days of statutory paid leave each year; an employee with a cumulative service period between ten years and twenty years will be entitled to ten days of statutory paid leave each year; and an employee with a cumulative service period of more than twenty years will be entitled to fifteen days of statutory paid leave each year.

7. How to terminate an employment contract under PRC law.

As mentioned above, PRC law is much more protective of employees than the laws of many Western countries. Under PRC law, only employees are given the right to terminate an employment contract without cause on thirty days' prior written notice (which will be reduced to three days' notice during the probation period), while employers cannot terminate an employment contract without cause. Employers can only terminate an employment contract based on certain grounds expressly provided in relevant PRC labor laws and regulations.

Generally, an employer may terminate an employment contract on the following legal grounds:

(1) Termination by agreement

An employment contract can be terminated at any time by agreement between the employer and the employee. In such case, if the termination by agreement is initiated by the employer, the employer will be required to pay severance compensation to the employee (see below for details on the calculation of severance compensation).

(2) Termination by employer without notice or compensation

An employer is allowed to terminate an employment contract without giving the employee prior written notice or paying severance compensation if (i) the employee on probation fails to meet the employment requirements; (ii) the employee has seriously violated the employer's policies; (iii) the employee is guilty of serious dereliction of duties, corruption and causes the employer to suffer significant losses; (iv) the employee is at the same time working for another employer, which has seriously affected his/her performance of current work tasks assigned by the employer, and refused to rectify the situation after being requested by the employer; (v) the employee used fraudulent or coercive tactics to obtain the employment contract or to amend the contract; or (vi) the employee is subject to criminal prosecution.

(3) Termination by employer by giving prior written notice and compensation

An employer is allowed to terminate an employment contract under any of the following circumstances, provided that it shall give the employee thirty days, prior written notice or pay one month's salary in lieu of notice: (i) where, after undergoing medical treatment for a period, the employee, due to illness or non work-related injury, is unable to perform his/her original duties or other work as arranged by the employer; (ii) where the employee is not competent to perform the work required and remains incompetent even after training or reassignment to another post; or (iii) where an employment contract can no longer be performed due to changes in the objective circumstances that were relied upon as the basis for the contract, and no agreement can be reached between the parties to amend the contract.

Notwithstanding the forgoing, employers will not be permitted to terminate an employment contract based on these grounds if: (i) the employee has been exposed to occupational disease hazards and has not undergone a pre-departure occupational health check, is under medical observation, or there is reason to believe he or she has contracted an occupational illness; (ii) the employee has contracted an occupational illness or suffered a work injury while working for the employer and is confirmed to have wholly or partially lost his/her labor capability; (iii) the employee is suffering from illness or non work-related injury and is still in the stipulated medical treatment period; (iv) a female employee is in her pregnancy, maternity leave or breastfeeding period; (v) the employee has worked for the employer for at least fifteen years consecutively, and is less than five years away from legal retirement age; or (vi) any other circumstances recognized in relevant laws and regulations from time to time.

(4) Calculation of severance compensation

As mentioned above, an employer will be required to pay severance compensation to an employee if it terminates the employee's contract based on agreement or non work-related illness or injury. The severance compensation will be calculated based on (i) the average monthly pay of the employee during the previous twelve months immediately prior to the termination, or three times the average monthly pay of all workers in the city where the employee is hired (a fixed number published by the local government on a yearly basis), whichever is lower (collectively "Monthly Pay"); and (ii) the length of service period of the employee. Specifically, the employee will be entitled to receive one month's Monthly Pay for each completed year of service, with a cap of twelve months' Monthly Pay. In this context, a service period between six months and one year will be treated as one year for ease of calculation. In the event that the employee's service period is less than six months, half a month's Monthly Pay will be paid as severance compensation.

In addition, an employer is required to pay severance compensation to an employee upon the expiration of the employee's fixed-term employment contract, unless the employer offered to renew the contract based on the same terms or terms more favorable to the employee and the employee refused to accept the renewal.

8. Does PRC law allow noncompete covenants?

Although in general PRC law allows a noncompete covenant in an employment contract or confidentiality agreement, many foreign-invested companies find that noncompete covenants in the PRC are not as useful as they are in many Western jurisdictions. This is mainly because PRC law provides certain restrictions on the use of a noncompete agreement. Moreover, relevant PRC laws and regulations use many undefined broad terms in the context of noncompete provisions, which adds to the uncertainty concerning their effectiveness. First, employers are only permitted to impose noncompete obligations on their senior management staff, senior technical staff and other staff with confidentiality obligations. Second, the length of the noncompete period may not exceed two years. Third, employers are required to pay reasonable compensation on a monthly basis to the employees with noncompete obligations during the noncompete period. In this regard, relevant PRC laws and regulations do not give clear guidance on how to calculate the compensation. PRC law generally requires employees in breach of their noncompete obligations to pay damages to their employers, but the laws, regulations and cases do not provide clear guidance on how to calculate damages in such cases.

9. How much is an employer required to pay for employees' social insurance coverage under PRC law?

PRC labor law and regulations provide for employer and employee contributions to various statutory social insurance plans (i.e., pension, medical insurance, unemployment insurance, work-related injury insurance, maternity insurance, and, in some regions, a housing fund). There is no uniform standard at the national level for such contributions; the cost of these benefits is determined by local governments, as reflected in local rules, policies and practices. In most provinces, an employer's burden of various social insurance and housing fund contributions is about 45% of an employee's base salary, while the employee's burden is normally around 20%. Both employers' and employees' contributions to statutory social insurance plans are made on a pre-tax basis.

In addition, employers also may provide nonstatutory benefits for their employees, to be consistent with industry practice or to make them more attractive in recruitment. Such additional insurance will be subject to commercial terms, and the payment of premiums for such nonstatutory benefits may not be made on a pre-tax basis.

10. Can local employees of PRC-incorporated companies participate in the employee shareholding plans or stock option plans of the foreign affiliates of such PRC companies?

The answer to this question is yes, provided that relevant foreign exchange approvals and/or registrations have been duly obtained and completed. So far, the PRC foreign exchange authorities have already developed a clear and straightforward foreign exchange approval/registration system for PRC residents' participation in foreign *public* companies' employee shareholding or stock option plans (here, the PRC employees permitted to participate are limited to the employees of the foreign public companies' PRC-incorporated affiliates). Under this system, after having completed certain foreign exchange approval/registration procedures, the PRC resident employees under the employee shareholding or stock option plan can wire the proceeds they receive under the plan back to the PRC. However, the PRC foreign exchange authorities have not yet developed an operable foreign exchange approval/registration system for PRC residents participating in a foreign *private* company's employee shareholding or stock option plan, so local PRC employees currently are not able to wire the proceeds from such plans back to the PRC.

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