

The New Labor Contract Law of the People's Republic of China Significantly Increases the Enterprises' Cost

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The Standing Committee of the National People's Congress adopted the Labor Contract Law of the People's Republic of China ("The New Law") on 29th June 2007, which is effective from 1st January 2008. According to the New Law, an open-ended labor contract is required if the employee has worked for an enterprise for ten consecutive years. Consequently, an enterprise cannot dismiss the long-serving employees unilaterally. In other words, it offers a lifetime employment to employees under open-ended contract. Termination of these employees is prohibited unless the employees are serious misconduct or redundant. Under this summary dismissal, the employer must paid a compensation of more than one month' salary in lieu of notice and must obtain approval from the labor union and the related authorities . Hong Kong investors are worried the extra costs brought by the New Law. Most importantly, they may be exposed to the hidden hazards unknowingly.

Major Discrepancy Between the New and Old Laws

Comparing with the old labor law enacted in 1994, the major amendments of the New Law are summarized as follows:

1. Conclusion of Labor Contract

If an employer does not enter into a written labor contract with an employee within a year after commencement of work, the contract is deemed to be open-ended. According to the New Law, the employer shall pay the employee twice the monthly salary as compensation in case of disputes.

2. Conclusion of Open-ended Labor Contract

If an employee has worked for an enterprise for ten consecutive years, or renewed the fixed-term contract for the second time, the employer must enter into an open-ended contract with them.

3. Period of Probation

The period of probation is restricted by the length of labor contract. The enterprise is prohibited to extend the probation period arbitrarily. The details of New Law are as follows:

Length of Labor Contract	Probation Period
Less than 3 months	Not required
3 months but less than 1 year	Not exceeding 1 month
1 year but less than 3 years	Not exceeding 2 months
3 years or above	Not exceeding 6 months
No fixed-term	Not exceeding 6 months

In addition, during the probation period, the New Law requires employers to pay their employees salaries which is not less than 80% of their contractual salaries or the lowest-paid employee with the same position while either of them is not less than the local minimum salary standard.

4. Setting of Rules and Policies

In formulating the enterprise's significant rules and policies which affect the "direct interest of employees", the employer must seek the consent of employees or their representatives. Otherwise, these rules and policies will become invalid. However, there is no precise definition of "direct interest of employees" for the time-being.

5. Termination of Labor Contracts

Employees are entitled to terminate the labor contract at any time upon serving notice under the New Law if: (1) the employer fails to pay the social insurance in full; (2) the salary is not paid in full and on time; (3) the workplace safety or condition is not provided in accordance with the labor contract; (4) the company's rules and policies violate applicable laws and affect the employees' direct interest. Upon termination, the employees shall also be entitled to compensation from the employer under the New Law.

In addition, the enterprise has to retain the documentations of the labor contract for at least 2 years from the termination (it was only required for 6 months under the old law).

6. Widening the Scope of Payment of Compensation

Enterprises have to pay compensation under the following circumstances:

- Termination of labor contract is mutually agreed.
- Employee is forced to terminate the labor contract (under the circumstances mentioned in point 5 above)
- Employee is dismissed other than serious misconduct.
- Employee refuses to renew the fixed-term labor contract due to the less favourable terms and benefits offered upon expiry.

The compensation payment depends on the length of employment and the average salary prior to the termination or expiry of the contract. If the employee works for the company less than a year, half of a monthly salary is required to be paid as compensation. For every full year of employment with the employer, one month salary has to be paid. Please note that the length of employment period is counted from the actual day of employment commencement although the New Law only comes into force on 1st January 2008.

7. Non-competition Covenant Compensation

The New Law imposes a ceiling of penalty to the employee who violates the non-competition covenant. In case of violation, the employee shall be penalized by paying a compensation to its ex-employer. The maximum amount of penalty is 3 times of the monthly non-competition compensation previously paid by the ex-employer.

Implications for Investors

The New Law established with a view to enhance the protection of employees' rights and benefits. In particular, the New Law imposes tighter supervision and heavier penalty on non-signing of labor contract; use of short-term labor contract; extended probation period, and restriction on employment flexibility. Due to the significant inherent cost (especially the compensation payment in relation to the dismissal of employees), enterprise should understand the New Law and the future interpretation notes thoroughly. Enterprise should also review and re-formulate the existing labor contract, staff handbook and company's rules and policies in accordance with the New Law. If you are not familiar with these issues, please seek professional advice for good. ※