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Practice Group(s):

Labour and
Employment

Quick Tips on Dealing with Employment Termination Issues in China

On June 21, 2013, a United States medical supplies company executive was taken captive by Chinese employees in his Beijing factory. The employees have stated that the owner owes them two months' back pay and expressed concern that he would close the factory without settling salaries or offering severance. While the takeover has not been violent, this incident illustrates one of the many contentious employment issues arising in the Chinese operations of multinational companies as labor costs in China rise.

Since 2008, a series of labor laws, regulations, and judicial interpretations have been implemented to better protect employees and their interests in the workplace. As a result, multinational companies operating in China are facing increasing challenges not only to protect the employees' well-being, but also to maintain an effective workforce in light of the regulatory restrictions. Employment termination is one of the most difficult issues that multinational companies face in their China operations. To help avoid costly labor disputes, multinational companies should understand the framework and issues behind employment termination and consider taking preventative measures from the start of the employment relationship.

A. Legal Framework for Employment Termination

Employment termination occurs in two ways: either upon expiration of the employment contract or through early termination. Many termination issues faced by employers arise in the context of early termination. An employer typically cannot unilaterally terminate an employment contract at-will or without fault, unless the termination falls under certain statutory grounds. According to *PRC Labor Contract Law*, an employer may terminate the employment relationship early on the following grounds: 1) termination through mutual agreement between employer and employee; 2) termination due to fault or misconduct; 3) termination without fault; and 4) wrongful termination. Depending on the termination grounds, employers have different obligations with regard to both providing notice and severance. These obligations are summarized below:

1. **Termination through mutual agreement:** This type of termination occurs when the employer and employee mutually agree to terminate the relationship, but the employer generally provides severance payment to the employee in order to obtain employee consent on separation.
2. **Termination due to fault or misconduct:** Termination due to fault or misconduct occurs when the employer terminates the employment relationship based on the employee's material breach or other stated causes. This may include:
 - if the employee has not satisfied employment conditions during probation period;
 - if the employee has severely violated the company's rules or procedures;
 - if the employee has been seriously negligent in his duties or seeks private benefits, resulting in severe damage to the company's interests;
 - if the employee has committed a crime;

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- if the employee has additionally established an employment relationship with another employer which materially affects completion of his tasks with the first employer, or refuses to rectify the matter after the employer points out the problem; or
- if the employee has deceived, coerced, or taken advantage of the employer's difficulties, to cause the employer to conclude an employment contract, or to make an amendment, contrary to the employer's true intent.

When an employer terminates an employee for fault or misconduct, notice and severance are not required.

3. **Termination without fault:** Termination without fault occurs when the employer terminates the employment relationship for reasons not related to misconduct or for other stated causes. This includes:

- if the employee is sick or has sustained a non-work related injury and, after conclusion of the statutory medical treatment period, cannot engage in the original work or in other arranged work;
- if the employee is incompetent and remains incompetent after training or assignment to another post; or
- if performance of the original employment contract becomes impossible due to a material change in the objective circumstances upon which the employment contract was based at the time it was entered, and consultations between the parties fail to produce agreement on amendment of the contract.

When termination is without fault, the employer must provide 30 days' advance written notice or pay one month salary in lieu of the notice, in addition to the severance payment. The employer must also provide notice to the labor union before any unilateral termination. Certain groups of employees may not be terminated without fault, such as employees who are pregnant, and employees who have lost or partially lost the capacity to work due to occupational disease contracted during the employment period.

Where a material change in circumstances causes the economic layoff of either 20 or more employees, or 10% of the workforce, the employer must provide 30 days' notice of the reduction plan to a labor union and to all employees and then submit the plan to the local labor bureau. Employees with long fixed-term contracts, open-term contracts, or who are the only breadwinners in the family should receive priority with regard to retention. As previously mentioned, certain groups, such as pregnant employees may not be terminated. Upon submitting the plan to the local bureau, the employer may terminate the employment relationship under the following circumstances:

- where employer has severe difficulties in its production or operations;
- where employer is restructuring according to Enterprise Bankruptcy Law;
- if the employer changes products, introduces a major technological innovation, or adjusts its business operation methods, and after amendment of employment contracts, still needs to reduce employees;
- where the objective economic situation upon which the labor contract is based has considerably changed, and the employer is unable to perform the labor contract.

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4. **Wrongful termination:** Beside the above statutory grounds, any other types of unilateral termination would be considered wrongful. In the event of a wrongful termination, the employer may resolve the matter through arbitration / litigation, or through settlement, both of which may involve high legal costs and settlement fees. Employers should note that in the case of a wrongful termination, an employee can ask for reinstatement. If an employee does not wish to continue working for the employer or if reinstatement is not possible, then the employer must pay the employee double the amount of severance that would need to be paid if the employee had been lawfully terminated. Furthermore, the employer may be liable for salary payments during the period in which the terminated employee cannot work, which may result in higher settlement costs for the employer.

B. Practical Measures for Dealing with Employment Termination

Given the above framework, employers may take a number of practical and preventative measures to avoid costly labor disputes. Employers should be mindful of which types of termination situations where notice or severance payments are necessary. Employers should also note the statutory required amount for severance payments, such as providing a statutory severance payment of one month's wage for each full year of service (except for termination during probation or for cause), one month's wages for less than a full year but greater than six months of service, and half month's wage for less than six months of service. When dealing with the employment termination process, employers should ask themselves the following questions:

During hiring and employment period:

- Has our company created a detailed employee handbook for employees to sign and acknowledge?
- Has our company properly defined standards of “materiality” and seriousness” in our disciplinary policy and handbook, as well as objective appraisal benchmarks for evaluating competency?
- Has our company maintained detailed records of the employees' performance?
- Has our company provided proper alternatives, such as additional training or alternative positions, to employees prior to termination?
- Has our company established proper employee consultation and dispute resolution procedures?

During termination and post-termination period:

- Has our company drafted proper full releases for employees to sign in the event of a termination?
- Has our company paid any unpaid wages and settled for the proper amount to prevent future disputes?
- Has our company implemented proper post-termination procedures, such as providing written statements explaining termination and relaying important information regarding what to expect post-termination?

K&L Gates lawyers can assist companies in dealing with labor and employment law matters. If you have any questions regarding this alert, please contact the K&L Gates Beijing office.

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