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China Employment Law Update

Newsletter

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In This Issue:

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Amendment to China's Anti-Unfair Competition Law Strengthens Trade Secret Protections

On November 4, 2017, the Standing Committee of the National People's Congress passed the amendment to the PRC Anti-Unfair Competition Law (the "**AUCL**"), which will become effective on January 1, 2018 ("**Amended AUCL**"). The Amended AUCL provides clarity on what constitutes trade secret infringement and increases penalties to strengthen trade secret protections.

Key changes include:

- **Information is more likely to qualify as a trade secret** – According to the original AUCL, the elements of a protectable trade secret were: (i) the information is of a technical or business nature; (ii) it is non-public; (iii) it has practical applicability; (iv) it brings economic benefits to the owner; and (v) the owner has adopted appropriate measures to maintain its confidentiality. According to the Amended AUCL, elements (iii) and (iv) have been replaced with the phrase "having business value", which loosens the criteria to determine whether a piece of information qualifies as a trade secret.

- **New focus on preventing unfair competition by employees, ex-employees and ex-employees' new employers** – The original AUCL imposed confidentiality obligations on the recipients of trade secrets, including third parties who receive a trade secret knowing that it was disclosed in breach of a confidentiality obligation. The Amended AUCL further clarifies that employees and ex-employees of the rights holder are subject to this provision. This clarification likely reflects the focus on prohibiting acts of unfair competition committed by employees or by ex-employees and their new employers.

- **Significantly increased administrative fines** – Under the original AUCL, the administrative fine for trade secret infringement ranged from CNY 10,000 to CNY 200,000. Under the Amended AUCL, the administrative fine for trade secret infringement now ranges from CNY 100,000 to CNY 3 million. However, the Amended AUCL allows mitigated administrative penalties if: (i) the infringer proactively eliminates or reduces harmful consequences; or (ii) the infringement is minor or does not cause any harm and is rectified in a timely manner. This mitigation measure would allow the administrative authority to reduce fines below the statutory minimum of CNY 100,000.

- **Civil damages potentially higher** – The damages payable to the victim under the Amended AUCL are not limited to the costs to investigate the unfair competition activities but cover any reasonable expenditure for stopping the misconduct, which implies that litigation costs and attorney fees could potentially also be recoverable.

- **Expanded governmental supervisory authority** – The Amended AUCL grants the governmental supervisory authority the power to seal or seize property as well as additional powers to check bank accounts of business

operators who have allegedly committed acts of unfair competition, such as theft of trade secrets.

Key take-away points:

The Amended AUCL has strengthened trade secret protections. No employer should improperly use, or allow any of its employees to disclose or use, any information or trade secret of their former employer or any other person or entity to whom the employee owes a confidentiality obligation.

To mitigate risks of having one's trade secrets infringed, employers should enter into confidentiality agreements with their employees who have access to trade secret information, preferably with a relatively detailed definition of what constitutes confidential information, since then the company can argue that it took appropriate measures to protect that particular type of information. Furthermore, employers can issue warning letters to ex-employees and their new employers if it appears the ex-employee and the new employer are infringing or potentially may infringe on the former employer's trade secrets.

Major National and Local Developments Related to the Employee Housing Fund System

There are two recent updates in China's housing fund system. First, the national government is now encouraging employees from Hong Kong, Macao and Taiwan to enroll in the housing fund system. Second, Shanghai has issued new rules to strengthen the enforcement of housing fund compliance.

1. *Employees from Hong Kong, Macao and Taiwan ("**HMT Employees**") Encouraged to Participate in China's Housing Fund System*

On November 28, the Ministry of Finance, along with other national level government authorities, issued the *Opinions on Issues Regarding Hong Kong, Macao and Taiwan Employees' Entitlement to the Housing Fund* to encourage HMT employees to participate in the mainland housing fund system.

Currently, in most cities, HMT Employees are still not able to enroll in the housing fund system, even as some cities (such as Guangzhou and Shenzhen) have recently issued new rules allowing HMT Employees to participate in the local housing fund system. Although the housing fund opinion does not make participation in the housing fund mandatory for HMT Employees, it does require local governments to enact measures to allow HMT Employees to participate in the local housing fund system.

The housing fund opinion further requires that the housing fund contribution rates, procedures and access should be the same for HMT Employees as for employees from mainland China. When HMT Employees cease working in mainland China, they may withdraw the funds from their personal housing fund accounts.

2. *Shanghai Issues New Rules to Strengthen Housing Fund Compliance Enforcement*

In September, Shanghai issued the *Management Rules on Housing Fund Non-compliant Practice List*, effective on October 9, 2017. The rules direct

the municipal housing fund center to strengthen the enforcement of employer and employee housing fund compliance.

According to the rules, the housing fund authority will establish a list of employers and employees with non-compliant housing fund records. Employers should particularly note that they will be added to the serious non-compliance list for certain types of non-compliance, such as being fined by the housing fund center for not conducting housing fund registration or not setting up personal accounts for employees, or being ordered by the municipal housing fund center to make back payments within a specified period of time for non-payment or underpayment of housing fund contributions.

After being added to the serious non-compliance list, an employer should expect to receive more frequent inspections from the housing fund authorities and to have its non-compliance record publicized on Shanghai's Public Credit Information Service Platform.

Key take-away points:

The opening up of the housing fund system to HMT Employees may encourage more of them to participate in local real estate markets, and may lead to employers facing demands or requests from HMT employees to enroll them into the system even though it is not legally required.

In terms of housing fund enforcement in Shanghai, the Shanghai housing fund opinion indicates that the Shanghai government will become more aggressive in monitoring employers' housing fund compliance. Employers in Shanghai should establish proper internal audit mechanisms to ensure their housing fund compliance.

Repeal of Regulations May Impact Calculations of Economic Compensation for Employees

The Ministry of Human Resources and Social Security announced on November 24, 2017 that it has repealed certain labor rules, including the *Measures for Economic Compensation for Breach and Termination of Employment Contract* ("**Circular 481**"). With Circular 481 repealed, calculation of the medical subsidy payable by the employer upon early termination of an employee due to using up the statutory sick leave may be affected. Severance payment calculations for pre-2008 service years likely will remain unchanged.

Circular 481 was issued in 1994 as a supporting rule to the PRC Labor Law. It provided detailed calculation methods for economic compensation stipulated in the PRC Labor Law. In general, it covered three areas:

- penalties for underpayment of labor compensation (including salary and overtime payment) and severance
- statutory severance
- medical subsidy payable by the employer upon early termination of the employee due to the employee's inability to return to work after using up his statutory medical treatment period.

After the PRC Employment Contract Law ("**ECL**") entered into effect on January 1, 2008, Circular 481 was partially superseded, in particular for those provisions on penalties for underpayment of labor compensation and severance. The ECL established that statutory severance for post-2008 service years was to be calculated according to Article 47 of the ECL, while statutory severance for pre-2008 service years was to be calculated according to existing rules, which at the time mainly meant Circular 481 for localities that did not have their own local severance calculation rules. Since the ECL was silent on the medical subsidy, Circular 481, together with other applicable national and local rules, was still used as the legal basis for calculating the medical subsidy.

The repeal of Circular 481 will not affect the penalties for underpayment of labor compensation and severance that were already superseded by the ECL. However, it is unclear how the repeal of Circular 481 will affect the calculation of severance for pre-2008 employment and of the medical subsidy.

The prevailing interpretation among legal commentators is that Circular 481 can still be used as the calculation standard for severance for pre-2008 employment because the ECL specifically stipulates that severance for pre-2008 employment should be calculated in accordance with the prevailing severance payment rules before the ECL entered into effect, i.e., the old rules were grandfathered in. Under this interpretation, the prevailing rules on severance for pre-2008 employment (e.g., Circular 481) would still apply even though they may have been repealed or superseded; therefore, the repeal of Circular 481 should not impact the calculation of severance for pre-2008 employment. But it remains to be seen whether any authority or court will endorse this prevailing interpretation in a new rule or court guidance, or whether any labor tribunal or court will follow it in a decision.

However, there is still a gap in the law on the calculation of the medical subsidy. The ECL makes no direct or indirect reference to a rule on calculating the medical subsidy. Instead, with the circular now repealed, employers in localities with local rules on the calculation method for the medical subsidy (e.g., Shanghai and Jiangsu Province) will now need to rely on those local rules, whereas employers in localities without local rules on the calculation method for the medical subsidy will now find themselves without a clear legal basis for the calculation. As such, other national rules or local rules will need to be promulgated to clarify what calculation method to use.

Key take-away points:

Employers should monitor follow-up developments related to the repeal of Circular 481. Until calculation standards are clarified, employers are recommended to carefully check local regulations, consult with the local labor bureaus and seek legal assistance when calculating the severance for pre-2008 service years and the medical subsidy payable by the employer for early termination of an employee due to the expiration of the medical treatment period.

PRC Holiday Schedule Announced for 2018

The State Council announced the adjusted holiday arrangement for 2018, which contains non-working days in addition to official public holidays and

swaps weekend days for working days to provide workers with a longer consecutive period of time off work.

Official Public Holiday	Adjusted Holiday Arrangement
New Year's Day (1 day, January 1, 2018)	Non-Working Days: December 30, 2017 - January 1, 2018
Spring Festival (3 days, from February 15 - 17, 2018)	Non-Working Days: February 15 - 21, 2018 Working days: February 11, 2018 (Sunday), February 24, 2018 (Saturday)
Tomb Sweeping Day (1 day, April 5, 2018)	Non-Working Days: April 5 - 7, 2018 Working days: April 8, 2018 (Sunday)
Labor Day (1 day, May 1, 2018)	Non-Working Days: April 29 - May 1, 2018 Working Days: April 28, 2018 (Saturday)
Dragon Boat Festival (1 day, June 18, 2018)	Non-Working Days: June 16 - 18, 2018 Working Days: June 19, 2018 (Tuesday)
Mid-Autumn Festival (1 day, September 24, 2018)	Non-Working Days: September 22 - 24, 2018 Working Days: September 25, 2018 (Tuesday)
National Day (3 days, October 1 - 3, 2018)	Non-Working Days: October 1 - 7, 2018 Working Days: September 29, 2018 (Saturday), September 30, 2018 (Sunday)

Key take-away points:

All employers must follow the official public holiday schedule, whereas only government employers and state-owned companies must follow the adjusted holiday arrangement. Private companies are exempt from the adjusted holiday arrangement. However, most private companies in China still follow the adjusted holiday arrangement because employees generally expect those additional days off.

Shanghai Amends Regulations on Employee Representative Councils

On November 23, 2017, the Standing Committee of the Shanghai People's Congress voted through amendments to the *Regulations of Shanghai Municipality on Employee Representative Councils* ("**ERCs**"). The amendments will take effect on January 1, 2018.

According to the amendments, when an employer decides on major operational matters, including restructuring, merger, separation, relocation, shutdown, dissolution, bankruptcy, etc., the employer must listen to employee opinions and suggestions through the ERC or other means in accordance with the law. If the employer fails to follow this requirement, the labor union can submit a written request for corrective action, and the employer must

rectify the failure and reply to the labor union in writing. Further, if a breach of the regulations leads to labor unrest or if a company receives a recommendation from the union to rectify a breach of employee rights, the local authorities may investigate and then order rectification within 30 days. If the company still does not rectify, it may affect the company's credit rating.

To ensure the ERCs are fulfilling their responsibilities, the municipal and district labor authorities and the labor union will examine the performance of the ERC system at a company during their regular joint inspections of the employer.

Key take-away points:

The amendments are an attempt to put more teeth on the existing regulations and push more companies to establish ERCs and consult with them on major operational matters. However, it remains to be seen how aggressively the local labor authorities will enforce the amended regulations and how much focus they will put on this during their regular inspections/audits of companies. In any event, companies in Shanghai should be prepared to face questions about the establishment and functioning of an ERC in their company during labor inspections/audits.

Shenzhen Issues Guidance on Labor Dispute Arbitration

On September 8, 2017, the Shenzhen Labor Dispute Arbitration Commission issued meeting minutes to its district-level labor dispute arbitration commissions. The meeting minutes clarify several issues, including instructions for labor dispute arbitration commissions to:

- invoke the statute of limitations for arbitration only if a party involved raises it as an affirmative defense
- support employee severance claims where the employee is forced to terminate the employment contract because the employer did not pay full salary or did not pay salary on time during a suspension-of-work-with-pay period
- support employer claims for the return of non-competition compensation if an employee violates a non-competition obligation during the non-competition period.

The meeting minutes also address liquidated damages for non-competition violations. The meeting minutes explain that: (i) an employer can claim liquidated damages for an employee's repeat violations of a non-competition obligation; and (ii) the employee must continue to abide by the non-competition obligation even after paying liquidated damages if so required by the employer.

Key take-away points:

Even though the meeting minutes are not legally binding and are only guidance, in practice the district-level labor dispute arbitration commissions will likely follow them. Therefore, companies in Shenzhen should be aware of the effect the meeting minutes will have on labor dispute arbitration rulings in Shenzhen.

Beijing High Court Rules Dismissal Lawful for Employee Who Lied About Traveling While on Sick Leave

The Beijing High People's Court recently reversed lower court judgments that a China internet company had illegally terminated an employee for travelling to Brazil while on sick leave.

The employee applied for two weeks' sick leave using a hospital medical certificate that stated "Cervical Spondylosis. Suggest taking rest for two weeks." The company approved the sick leave but later found that the employee had travelled to Brazil during the sick leave period. The employee refused to admit to the travel, so the company terminated the employee for lying to the company, which violated the employee handbook.

The first and second instance courts deemed the termination illegal because the employer's company policy did not restrict the location where an employee could take sick leave. The High Court ignored this question and instead ruled the termination legal because the employee violated the company's honesty principle. The High Court viewed the employee's conduct during sick leave as inconsistent with the reason for taking sick leave. Thus, the company had a right to question the employee about the travel. By lying to the company about the travel, the employee violated the company's honesty principle. Therefore, the termination was legal on those grounds.

Key take-away points:

Employers in Beijing with company policies containing an honesty principle should welcome this judgment because it allows dismissal of employees who lie about conduct that in itself does not directly violate company policy. However, even if the employer's company policy contains an honesty principle, the employer should not rely too heavily on it as a grounds and a strategy for dismissal. Instead, employers should ensure their company policies are as detailed as possible to provide direct grounds for termination.

Nantong Court Deems Hire of Non-pensioner Retiree to Create Special Employment Relationship

Recently, the Nantong Municipal People's Court in Jiangsu Province upheld a retiree's claim that an employment relationship existed between a company and the retiree. The retiree was hired by the company after reaching the statutory retirement age, but the retiree had not drawn a pension from the social insurance fund.

The company entered into a signed service agreement with the retiree. After the service agreement expired, the employee continued to work at the company without entering into a written renewal agreement. The employee filed a claim that the service relationship had become an employment relationship with the company. On this basis, the employee sought compensation from the company for its failure to enter into a written employment contract and for its salary payments being less than the local minimum wage.

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

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

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The court ruled that even though the employee had reached the statutory retirement age, the relationship could not be a service relationship because the employee was not drawing a pension from the social insurance fund. By not drawing a pension, the relationship was more similar to an employment relationship; thus, the court ruled that the relationship should be deemed as a special employment relationship.

In terms of compensation, the court granted one claim and denied the other. The court ruled that the company and the employee could orally agree to their rights and obligations under a special employment relationship; thus, a written employment contract was not required and no compensation was owed for the failure to enter into one. However, the court ruled that the employer was obligated to pay the local minimum wage under a special employment relationship, and so the employer was ordered to pay the difference between the employee's salary and the local minimum wage.

Key take-away points:

National laws and regulations conflict about when an employee's employment relationship ends. The *Employment Contract Law* provides that the employment relationship ends when the employee starts drawing a pension, while the *Implementing Regulations of the Employment Contract Law* provide that the employment relationship ends when the employee reaches the statutory retirement age. This inconsistency has led to confusion about the employment status of employees who have reached statutory retirement age but have not drawn pensions, and different courts have come to different positions on this issue.

This case shows that an employer could be deemed to have formed a special employment relationship with a retiree if the employer hires a retiree who has not yet drawn a pension from the social insurance fund. To avoid having the retiree deemed as an employee, the employer should first ensure the retiree is drawing a pension from the social insurance fund and then sign a service agreement with the retiree.