

China Employment Law Update

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New Developments in Labor Dispatch

Following the recent amendment to the Employment Contract Law ("**ECL Amendment**"), the PRC Ministry of Human Resources and Social Security (the "**MOHRSS**") issued the *Notice on the Implementation of the Amended Employment Contract Law and Strengthening the Regulation of Labor Dispatch* on January 23, 2013 (the "**Notice**").

According to the Notice, MOHRSS and local labor authorities should take the following actions to further implement the ECL Amendment:

- (i) MOHRSS will draft new implementing regulations on the use of labor dispatch and new measures regarding permit requirements for staffing agencies;
- (ii) local labor authorities should conduct surveys of the labor dispatch situation in their respective jurisdictions, as well as investigate and start correcting violations of statutory labor dispatch provisions; and
- (iii) local labor authorities must inspect licensed staffing agencies annually and revoke the permits of agencies that fail to pass the annual inspection.

On April 19, 2013, MOHRSS issued draft measures on permit requirements for staffing agencies, which are open for public comment until May 19, 2013. The draft measures stipulate the required documents and procedures for applying for a staffing agency permit, annual inspection procedures, and penalties for various types of violations. In addition, they stipulate that foreign investors may enter the labor dispatch business, but only in a joint venture with Chinese companies, and not in the form of wholly foreign-owned enterprises.

Separately, the State-owned Asset Supervision and Administration Commission ("**SASAC**") issued a notice to all state-owned enterprises under the direct supervision of the central government ("**Central SOEs**") regarding implementation of the ECL Amendment. The Notice conceded that many Central SOEs have misused or overused dispatched workers and called on them to fully implement the new restrictions and requirements in the ECL Amendment. Furthermore, any Central SOE with over 10,000 dispatch workers or which has a workforce in which over 10% are dispatch workers, should set up a working team devoted to standardizing the use of labor dispatch in

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line with the ECL Amendment and then submit a report regarding the measures taken to SASAC by July 1. It is uncertain whether MOHRSS will also refer to this 10% threshold when drafting its implementing regulations for the ECL Amendment.

In the meantime, dispatched workers have already begun to take matters into their own hands to protect their rights. In Shenzhen, a dispatched worker, who was seconded in succession by two staffing agencies to an e-commerce company for more than one year, was reported to have recently initiated an arbitration proceeding, claiming the labor dispatch arrangement was invalid and that he had a direct employment relationship with the e-commerce company. The dispatched worker's main argument is that his job position falls outside the statutory restrictions for labor dispatch (i.e. temporary, auxiliary and substitute job positions). If the arbitrator and courts rule in favor of the dispatch worker in this case, which has been widely reported in the Chinese media, it may open the door for dispatched workers to bring similar claims of *de facto* employment in other locations.

In light of the above recent developments, companies have further impetus to thoroughly check their labor dispatch practices (if any), identify any positions for which direct employment may be more appropriate, and check whether the staffing agency that they are using is properly licensed.

Amended Occupational Disease Diagnosis and Assessment Rules

The Ministry of Health issued the Amended Occupational Disease Diagnosis and Assessment Management Rules ("**Amended Rules**"), which took effect on April 10, 2013. The Amended Rules implement new requirements under the revised Occupational Disease Prevention and Control Law ("**Occupational Disease Law**"), effective on December 31, 2011.

Specifically, a diagnosis institute must accept an employee request to assess whether the employee has contracted any occupational disease, and no longer requires that the employee present any evidence. The employer, on the other hand, may be required to present relevant records which it has the obligation to maintain (such as the employee's occupational health medical check up history, occupational hazard exposure history, and workplace occupational hazard assessment, etc.). If the employer fails to produce relevant records, the diagnosis institute may make a diagnosis based on the totality of the records, evidence and information provided by the employee. Moreover, employers that fail to maintain or present the employee's occupational disease related records for diagnosis

purposes may be exposed to administrative fines or cessation of business (in a serious situation).

These Amended Rules should make it easier for employees to bring occupational disease claims, and increase the employer's compliance risks.

Shanghai Court Admits Reinstatement Judgment Difficult to Enforce

In a recent case reported on February 16, 2013, the Shanghai Jing'an District People's Court was reported as admitting that its judgment to reinstate a terminated employee was unenforceable when the employer refused to take the employee back or assign any work to the employee even after the court attempted to mediate between the parties on three occasions.

The employee had joined a Shanghai interior design company in September 2008, but no written employment contract was ever signed by the parties. On May 20, 2011, the company issued a termination notice to the employee based on the fact that the company lost many of its clients resulting from the employee's poor performance and improper behaviour during work. The employee applied for arbitration in May 2011 and asked for an open-term contract, back payment of wages owed from the date of termination, and reinstatement of employment. Both the arbitration tribunal and the court supported the employee's claims, reasoning that the company did not have sufficient evidence to justify the termination.

On May 18, 2012, the appellate court affirmed the ruling that the company must reinstate the employee, make back payments of wages for the period from termination until reinstatement, and sign an open-term contract with the employee (since PRC law deems an employee to be on an open-term contract if he works for more than one year without a contract).

After the judgment was given, the company refused to offer a job to the employee despite the employee's attempts to report to work. The employee filed another complaint requesting for back payments of salary up to June 11, 2012, which was again supported by the arbitration tribunal and the court. It is unclear whether the company adhered to the other terms of the judgment by making the payment. It is reported that the court was unable to force the company to hire the employee on an open-term contract after three attempts in vain to mediate between the parties.

Under the law, an employer can be ordered to reinstate an employee who is found to be wrongfully terminated. In practice, however, it may be difficult for an arbitration panel or court to force a company to take

back an employee if the company refuses to do so. Although under PRC law, an offender who refuses to perform the terms of a valid judgment may be subject to criminal liabilities if such refusal causes “serious consequences”, mere refusal to rehire an employee may not be deemed to reach the requisite level of “seriousness”. Nevertheless, an employer should still be concerned about reinstatement judgments, because the employee may keep bringing claims and requesting back payment of salaries even though he/she does not actually go to work, thereby essentially costing the employer the same amount as if the employee had been allowed back to work.

Sexual Harassment Claim Dismissed For Lack of Evidence

Recently, the Beijing Haidian District People’s Court ruled against a female employee’s sexual harassment claim against her direct supervisor. The employee, working in a foreign-invested bank, alleged that the supervisor verbally and physically harassed her on three separate occasions (including one instance where the supervisor tried to forcefully kiss the employee). The court, however, found that there was no evidence to justify the employee’s claim, and thus dismissed the case.

The Women’s Rights Law explicitly prohibited sexual harassment in 2005. However, it does not define what types of behavior are considered to be sexual harassment, nor does it specify the punishment for sexual harassment. Under the 2012 Female Employee Protection Special Regulations, an employer has a legal obligation to take measures to prevent and stop sexual harassment against female employees. Therefore, in theory, failure to take such measures could expose the company itself, and not just the harasser in question, to legal liability for damages suffered by the victim. However, the regulations provide no clarification as to what exact measures need to be taken by the company.

In the absence of new legislation, the difficulties for female employees to successfully bring sexual harassment claims will remain. Companies are still recommended to take reasonable measures to try to prevent sexual harassment from occurring in the workplace.

Pregnant Employee’s Claim to Nullify Separation Agreement Dismissed by Court

A court in Dongguan City, Guangdong Province reportedly ruled against an employee who requested that her mutual termination agreement with the company be nullified on the ground that when signing the agreement she did not know that she was pregnant, and claimed for reinstatement of her employment.

Twenty days after the termination of her employment, the employee found out that she had been pregnant for over six weeks. She requested to cancel the mutual termination contract because she misunderstood her health condition at the time of signing the agreement. The company, however, maintains that the employee signed the agreement voluntarily and under PRC law an employee's pregnancy does not restrict the parties from being able to mutually terminate their employment relationship. The court supported the company's defence.

Although the court ruled in favor of the company in this case, statutory law is unclear regarding the extent to which a mutual termination agreement may be nullified if an employee later discovers she was pregnant at the time of signing the agreement. Courts in other cities handling similar cases have reportedly taken the opposite position to this Dongguan court.

Termination of Employee Five Years After Serious Misconduct Ruled Unlawful

In a recently reported case, the Shanghai Yangpu District People's Court ruled against a company for termination of an employee who had committed misconduct five years before.

The employee had signed a one-year employment contract with a company in Shanghai to act as its sales manager in 2006. In 2007 and 2009, respectively, the company renewed his contract and promoted him. In July 2011, the company terminated the employee's employment contract for serious misconduct. The employee admitted that from 2006 to 2007, while working for the company, he kept "off the book" accounts without notifying the company or other colleagues, and did not transfer such accounts to his successor during the transition. The employee, however, argued that he left his original position in 2007, and according to the company's finance and audit systems, it is impossible that the company only became aware of his separate accounts in 2011; therefore, the company's termination lacks legitimate grounds.

The court ruled that because the employee's misconduct occurred during the term of his first employment contract with the company, the company should have taken disciplinary action at that time. Since the company failed to take any action and instead renewed his contracts twice, the company is deemed to have waived its claims against the employee for the misconduct, and cannot terminate the employee for his previous misconduct during the prior contract terms.

This case shows that employers should take disciplinary action and make termination decisions in a timely manner as soon as they

discover any misconduct. If the company waits too long to make a decision on disciplinary action, it may be deemed as invalid. In addition, when the company decides to renew an employee's employment contract, it may be deemed to have waived its claims against the employee for his prior misconduct.

Employees' Demand for Severance Not Supported by Shenzhen Labor Authorities

In January 2013, a processing factory (known in Chinese as *sanlaiyibu*) in Shenzhen decided to convert to a normal limited liability company, and requested employees to sign an amendment to their employment contracts. The employees refused to sign the amendment and requested the processing factory to pay severance to buy out their years of service prior to the conversion. The local labor authority supported the company against the employee's severance demands and explained to the employees that their demand had no legal basis. Eventually, the labor authorities convinced the employees to drop their demand and resume their work.

The processing factory is a special form of enterprise in China that became very common in southern China during the early years of the "opening up reform" policy. Basically, it is a kind of economic cooperation organization formed by and between foreign and Chinese companies, and has no legal person status. In a processing factory, the foreign partner usually provides the required equipment, technology, funds, materials, components and product models and is responsible for importing and selling the products processed/assembled by the factory, while the Chinese partner is usually responsible for providing the required land, workspace and manpower.

In recent years, increasing numbers of processing factories have been converted to limited liability companies with legal person status, particularly since local governments started ordering such conversions by a specific deadline. Given the unclear legal status of these processing factories, many questions have arisen over their exact employment obligations and these have never been resolved by statutory laws. Recently, there have been multiple instances where employees have taken the position that the change in enterprise form is a change of employer and have taken collective action to demand payment of severance. The above case illustrates that labor authorities will not necessarily support employee demands; however, as the law is unclear on this issue, other labor authorities may take a different view.

Employer's Claim Against Employee for Economic Losses Partly Upheld by Court

In a recent case reported on March 11, 2013, the Beijing Daxing District People's Court upheld an employer's claim for compensation for economic losses caused by its employee. The Beijing No.1 Intermediate Court affirmed the judgment on appeal.

The employee resigned from his position as a car insurance claims officer. Before resigning, the employee and employer noted on a work interchange sheet that the employee was responsible for RMB 12,395 in losses for mishandling 47 first-time-car-maintenance applications. The employee then signed the work interchange sheet.

After the employee's separation from the employer, the employer discovered that the losses caused by the employee actually exceeded RMB 280,000. The company applied for labor arbitration against the employee and claimed RMB 280,000 in losses. The arbitration committee awarded the employer RMB 5,348 for economic losses. Both parties were dissatisfied with this award and filed suit in the Beijing Daxing District People's Court.

The court ruled that the employee should compensate the employer RMB 12,395 because:

- (1) the Employee Handbook states that an employee is 100% liable for the employer's or customer's losses due to work mistakes or other subjective reasons not in violation of the law; and
- (2) the employee admitted responsibility for the work mistakes that led to the losses by signing the work interchange sheet. The employee appealed, but the appellate court affirmed the judgment. The case report did not cover how the courts addressed the validity of the company's claim for RMB 280,000, though the courts likely only awarded RMB 12,395 in damages because that was the only damages amount for which there was documented proof.

This case shows that an employer can hold an employee liable for the economic losses caused by the employee. But it is important to note that the employer must provide written evidence from the time the losses occurred to prove that the losses were caused by the employee. Also, having a written basis, either in the employment contract or employee handbook, is important when claiming damages from an employee for losses caused.

Should you wish to obtain further information or want to discuss any issues raised in this newsletter with us, please contact:

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Company Ordered to Compensate Student Intern RMB 900,000 for Work Injury

On March 12, 2013, the Shenzhen Intermediate People's Court reportedly held an appeal hearing after the Shenzhen Bao'an District People's Court ordered a company to pay RMB 878,000 to a student intern for an injury that occurred at the workplace.

The student intern, a second year undergraduate in Shenyang Aerospace University, reportedly undertook a part-time work-study internship (*qingong zhuxue*) during his winter holiday in 2012. During the internship, his right hand and forearm were crushed while operating machinery at the factory. His injury was determined by a Guangdong judicial appraisal center as a grade six disability.

The student filed a lawsuit against the company, claiming for compensation of approximately RMB 930,000. Although the company argued that the student was employed by a labor service agency and that his injury should be covered by the work injury insurance system, the court ruled that no employment relationship was established with either the company or the labor service agency, and thereby ordered compensation of RMB 878,000 as disability remedy, expenses for disability assistance and compensation for missing work.

The case, which is still in the appeals process, demonstrates the risks of employing student interns, since they are not covered by the work injury insurance system applicable to employees (and which covers most costs related to an employee's work-related injury). Companies should therefore consider purchasing commercial insurance to cover accidental injury and/or death of interns.

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