Legal Affairs Committee
National People's Congress
P.R.C

Beijing, April 18, 2006

To whom it may concern,

**Re: Comments of the European Union Chamber of Commerce in China on the Draft Labour Contract law**

The European Union Chamber of Commerce congratulates the Ministry of Labour and Social Security (MOLSS) for the intention of drafting such a complex law and clarifying various aspects of employment relationships. Many of the provisions share a number of similarities with labour legislation in Europe allowing for Chinese authorities to draw upon the experiences of their European counterparts. Indeed, there is great scope for future cooperation, particularly with regards to the interpretation of the rules. By providing Chinese authorities with a set of comments drawn from the day-to-day experience of our member companies, the European Chamber wishes to provide a constructive assessment of the draft law.

The European Union Chamber of Commerce in China (European Chamber) is made up of more than 800 European companies active in China and serves member companies by being the voice of European business in China. The Chamber is built around a core of industry-specific Working Groups which meet regularly to discuss business issues in their respective industries.

## General Comments

The declared aim of the employment contract law is to protect employees and create harmony between the employer and the employees. Such objectives are commendable and certainly deserve further attention from both government and industry. Nevertheless, in order to ensure that these aims are met, some issues in the draft law will need further consideration and subsequent clarification.

The European Chamber acknowledges that many of the articles presented in this draft law stem from labour laws in Europe. However, we would like to take this opportunity to stress that the current labour regulations in several European countries pose a number of challenges to respective governments. Due to employee overprotection and rigid obligations for employers,

many European companies have decreased their hiring rates, increasing the burden on the state social systems.

Indeed, the current labour laws in several European countries have resulted in increased labour costs leading a number of European companies to relocate their production lines to countries outside Europe or to countries with more liberal labour legislation within Europe. As it stands, if China chooses to implement the changes suggested in this draft, such challenges will undoubtedly be experienced here as well. The strict regulations of the draft new law will limit employers' flexibility and will finally result in an increase of production costs in China. An increase of production costs will force foreign companies to reconsider new investment or continuing their activities in China.

The nature of China's economy is different to that of most European countries. Over the last century the economies of most member states of the European Union transformed themselves from a labour intensive economy to a capital intensive one with a strong focus on innovation and high-technology supported by an ever-growing skilled workforce. China's economy is now undergoing a similar transformation, although at a much more rapid pace. On the downside this remarkable growth could result in social instability. Whilst the intention of the legislator in giving increased protection to employees as the weaker party of employment relationships is laudable a more balanced approach between enhanced employee protection and continued economic growth should be considered.

The European Chamber eagerly anticipates more concrete guidelines for the implementation of this legislation. A number of articles in the draft are written in a rather vague manner making interpretation ambiguous, and implementation difficult to achieve. As labour contracts establish a long term relationship between the parties involved, clarity would encourage a more harmonious development of this relationship. Clear termination rules for contracts would encourage employers to give a larger number of potential employees a chance to prove their abilities without running the risk of being unable to terminate the contracts.

In certain areas the draft tends to over regulate the employment relationships. Based on our members' experience from various European and non-European countries however, we know that such legislation in order to be efficient needs to be flexible enough to apply to various business situations. Very detailed and rigid rules and regulations may potentially lead to unavoidable conflicts between the parties.

In the following section, specific comments will focus on those Articles of the draft law that we believe require further considerations.


**Specific Comments**

**1. Labour Unions**

In general it is felt that the role of Labour Unions/Employee Representatives etc. must be clearly defined. The guiding principle should be that the management may be obliged to consult the employees in certain areas before making a decision; the management should however maintain the right to a final decision.

- Article 7: Collective Contracts

*"Labor unions or employee representatives have the right, following bargaining conducted on an equal basis, to execute with Employers collective contracts on such matters as labor compensation, working hours, rest, leave, work safety and hygiene, insurance, benefits, etc."*

The supremacy of these collective contracts has to be defined. Questions such as whether collective agreements precede over individual agreements, whether the employees are allowed to choose which to apply and whether collective agreements are generally binding, i. e. how and under which circumstances can employers and employees amend or cancel such agreements, still remain unclear.

Today's practice would not allow fixed payments for defined job levels. The variety of skills and experience requires the adaptation of salary bands in almost all levels to enable necessary distinctions. We therefore recommend stipulating market oriented flexibility in this article.

Further comments on the role of Labour Unions will be made in the context of regulation requiring their involvement.

**2. Employment Relationships in General**

- Article 3: Interpretation of Employment Relationship

***"*** *For the purpose of this law, the term " Employment Relationship" means the relationship of rights and obligations which arise when an Employer recruits a worker as a member of its organization and the worker, under the management of the Employer, performs remunerated work"*

Many companies, especially in the service sectors, have established service agreements with their employees, which are directly tied with incentive packages and the availability of the employee. Such agreements offer a win-win situation for both the employee and the employer since the employee is able to operate on a flexible schedule and the employer reduces costs since such temporary employees are not permanent staff of the company. Practitioners and arbitrators have traditionally recognized such service agreements worldwide.

We understand that article 3 does not permit this type of service agreement anymore but would require in any case to conclude an employment contract. This will significantly increase costs for companies in the service sectors since companies will now be responsible for temporary employee's social security as well as severance payments.

- Article 9: Factual Labour Contracts

*"[…]*
*If an Employer and a worker have different opinions as to whether an Employment Relationship exists between them, the opinion favoring the worker shall prevail unless there is proof to the contrary."*

Whilst they do agree that factual labour relations need legal protection to a reasonable extent our member companies are concerned that the provision if released as stipulated in the current draft may stimulate certain individuals to try causing factual labour relations by various means in order to obtain a non-fixed term labour contract.

We therefore suggest that both parties' opinion should be equally taken into consideration when judging whether an employment relationship has been created.

- Article 10: Interpretation of Labour Contract Clauses

*"[…]*
*If the Employer and the worker construe the terms of the Labor Contract differently, the terms shall be construed in accordance with the usual interpretation. If there are two or more interpretations, the interpretation most favorable to the worker shall be adopted."*

It is often possible to interpret clauses in contracts in a number of different ways. This provision would put employees at an undue advantage regarding disputes and in litigations.

We propose to change this article so as to ensure that both the employer and the employee are treated equally in the case of a dispute settlement.

**3. Probation Periods**

- Article 13.

*"The probation period for non-technical positions may not exceed one month; that for technical positions may not exceed two months; and that for senior professional technical positions may not exceed six months."*

The definition of non-technical, technical and senior technical personnel needs to be clarified. As it currently stands, it is not possible to implement this law in a consistent manner if such interpretation is not clear at the time the employment contract is concluded, but left to the interpretation of the parties.

As the period necessary to asses the ability of an employee may vary from industry to industry and company to company we recommend to leave the definition of probation periods with the employer. Alternatively a maximum period may be stipulated.

**4. Company Rules**

- Article 5.

*" An Employer's rules and regulations that have a bearing on the immediate interest of workers shall be subject to deliberation and adoption by the labour Union, the employee congress or the employee representative congress, or formulated through consultations conducted on a basis of equality"*

- Article 51.

*" If an Employer unilaterally formulates regulations for a matter which, according to this Law, requires deliberation and adoption by the labour union, employee congress or employee representative congress or bargaining conducted on an equal basis, such regulations shall be invalid, and the matter shall be handled in accordance with the relevant plan proposed by the labour union, employee congress or employee representative congress"*

Traditionally, companies have formulated their own independent set of company rules in order to ensure certain codes of conduct and make sure company culture is sustained in the workplace. Company rules concern more than just codes of conduct; they concern a company's traditional values, beliefs and ethos. By involving the labour union in the creation of such rules, companies risk losing their traditional values and heritage.

The implementation of this article will create unnecessary difficulties for both the employer and the labour union in reaching agreements. It is felt that the current system which requires company laws to be made public by the company is satisfactory and also ensure that companies are able to successfully maintain their corporate cultures.

## 5. Non-Compete Clauses

- Article 16.

*"If an Employer has agreed on a competition restriction with a worker, it shall additionally agree with the worker on the non-compete compensation that it will pay him at the time of termination of the Employment Contract, the amount of which shall not be less than the worker's annual wage from the Employer. If a worker breaches the non-compete clause, he shall pay the Employer liquidated damages, the amount of which may not exceed three times the amount of the non-compete compensation paid to him by the Employer."*

We understand the fact that at least a one-year salary income is to be given to the employee for non-competition in order to ensure that company secrets are withheld. There is a need for clarification in terms of the exact payment procedure throughout the period that the non-compete clause applies.

Currently liquidated damages for employee in breach of non-competition clause is capped at three times the amount paid by the employer even though the breach of non-compete obligations may lead to a much higher economic loss for the employer. Further we recommend to take into consideration that the current procedure laws do not provide for an injunctive relief through which damage can be prevented.

Adequate protection of trade secrets and other intellectual property rights is crucial not only because more and more foreign companies are currently increasing the import of advanced technologies into China and even moving their research and development centres to China, but also in order to encourage the research and development of new technologies by Chinese companies.

Moreover there is a need for greater clarity with regards to the geographical limitations covered by the non-compete clause.

## 6. Training

- Article 15.

*"If an Employer pays for a worker's training to enable him to receive six months or more of off-the-job professional technical training, it may agree upon a service period with the worker and the*

*liquidated damages that the worker would be required to pay the Employer if he were to breach the agreement on the service period. The liquidated damages may not exceed the portion of the training expenses allocated to the unperformed portion of the service period."*

This provision gives employers practically no chance to ask for binding agreements. Training on the job does not fall under this regulation and employers are not able to define service return periods in those cases as well as for sponsorship of EMBA`s etc. Companies would either have to give up one of the most important retention tools or continue to sponsor various trainings with an uncontrollable risk of loosing highly skilled personnel. This is seen as a unjustified disadvantage for companies willing to invest in the competence development of their employees in China.

We would like to recommend enabling service return agreements to ensure a fair trade-off between the employee's and employer's interest.

## 7. Termination of Labour Contracts

- Article 35: The role of the trade union

*" When an Employer is to terminate an Employment Contract, it shall give the labor union advance notice thereof. If the Employer violates laws, administrative statutes or the Employment Contract, the labour Union has the right to demand that the Employer rectify the matter. The Employer shall study the labour union's opinions and notify the labor union in writing as to the outcome of its handling of the same. If the worker applies for labour arbitration or institutes a legal action, the labour union shall give its support and assistance."*

Many Small and Medium size companies have a limited amount of employees and hence do not have a trade union or employee representative bodies. Under the proposed circumstances a company is required to consult with the regional trade union, which has no prior relation with the company or knowledge of the case at hand. In such a case it is felt that the trade union may lack adequate information so as to provide an impartial opinion on the matter.

- Article 33: Mass lay off's

*"If a major change in the objective circumstances relied upon at the time of conclusion of Employment Contracts renders them under performable and there is a need to reduce the workforce by 50 persons or more, the Employer shall explain the circumstances to its labour union or to all its employees and hold consultations with the labour union or employee representatives to reach consensus. When reducing personnel, the Employer*

*shall retain with priority workers who have worked with the Employer fixed term employment Contracts with a relatively long term and those who have concluded open-ended Employment Contracts "*

We would like to recommend to further define the term "change in the objective circumstances". In the case of a mass lay-off, companies will be obliged to lay-off junior employees first. Companies may thus risk losing their most valuable staff members. We propose that companies should be able to make fair, objective and transparent decisions as to whom to lay off so as to preserve their business interests.

- Article 31: Reasons for termination

*"An Employer may terminate a Labor Contract if the worker:*

*(1) is proved during the probation period not to satisfy the conditions of employment;*

*(2) materially breaches the Employer's rules and regulations, and, according to such rules and regulations, the Labor Contract should be terminated;*

*(3) commits serious dereliction of duty or practices graft, causing substantial damage to the Employer's interests;*

*(4) has simultaneously established an Employment Relationship with another Employer which materially affects the completion of his tasks and he refuses to rectify the matter after the same is brought to his attention by the Employer; or*

*(5) has his criminal liability pursued in accordance with the law."*

- Article 32: Reasons for termination

*"An Employer may terminate an open-ended Labor Contract by giving the worker himself 30 days' prior written notice, or one month's wage in lieu of notice, if:*

*[…]*

*(2) the worker is proved incompetent and remains incompetent after training or adjustment of his position; or*

*(3) a major change in the objective circumstances relied upon at the time of conclusion of the Labor Contract renders it unperformable and, after consultations, the Employer and worker are unable to reach agreement on amending or suspending the Labor Contract."*

We recommend that the "incompetence provision" apply to all contract types and is not limited to flexible term contracts, i. e. employers should be able to also terminate fix-term contracts should the employee prove to be incompetent and more flexible performance related triggers for termination are included.

Additionally employers will not be able to dismiss employees during the probation period. We propose to allow terminating contracts during probation period for both parties without specified reasons.

- Article 39: Fixed term Contracts

*"In any of the following circumstances, the Employer shall, depending on the worker's years of service with the Employer, pay the worker severance pay at the rate of half a month's wages for each full six months of service and one month's wages for each full year of service; if a worker has served with the Employer for more than six months but less than one year, his severance pay shall be calculated at the rate for one year; if he has served for less than six months, his severance pay shall be calculated at the rate for six months: […]*

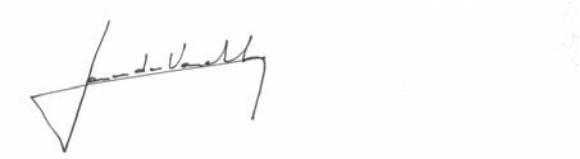
*- the Labor Contract terminates in accordance with item (1), (3) (4), (5) or (6) of the first paragraph of Article 37 hereof.*
*If the Labor Contract is renewed, the Employer shall not pay severance pay."*

This provision also applies for contracts with fixed terms. It is felt that it is not logic, that the employer should pay compensations in case a fixed-term contract expires as agreed between the parties. This provision together with the aforementioned impossibility to terminate fixed term contracts except for cause or in case of mass lay offs will restrict the use of fixed-term contracts and may potentially lead to decreased hiring activities.

We therefore propose to exclude fixed term contracts from this provision.

We thank you for your consideration. The European Union Chamber of Commerce is open for discussion and consultation on this matter. I invite you to contact our Government affairs manager Ms. Wang Ping on pwang@euccc.com.cn - tel (10) 6462 2066 Fax: (10) 6462 2067.

Kind regards,



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