

CHINA'S NEW LABOUR CONTRACT LAW: RESPONDING TO THE GROWING COMPLEXITY OF LABOUR RELATIONS IN THE PRC

SEAN COONEY*, SARAH BIDDULPH**, LI KUNANG*** AND YING ZHU****

I INTRODUCTION

China's new Labour Contract Law¹ is the most significant reform to the law of employment relations in more than a decade. Its final form emerged following highly contentious debates over the terms of earlier drafts – debates involving not only a range of Chinese actors, but also international business lobbyists and labour organisations. The Law as enacted represents a compromise between the competing demands of these many interest groups.

This article briefly surveys the reasons for the enactment of the Labour Contract Law, the polarised drafting process, and the key matters it addresses.² The assessment presented is that the Law is, overall, a necessary and beneficial contribution to the regulation of work in China. However, the article highlights four areas likely to be subject to ongoing contention and dispute.

* Sean Cooney is Associate Director of the Asian Law Centre and an Associate Professor at the University of Melbourne.

** Sarah Biddulph is Associate Director of the Asian Law Centre and a Senior Lecturer of Law at the University of Melbourne.

*** Li Kungang is Associate Professor of Law at Anhui University.

**** Ying Zhu is Associate Professor of the Department of Management at the University of Melbourne. This work was supported by ARC funding. Special thanks to Andrew Godwin for his comments on the draft. Thanks also to the anonymous referees for their very helpful suggestions. Owing to space restrictions, it was not possible to incorporate many of these suggestions into this article. However, the authors intend to deal with many of these issues raised in subsequent work.

1 This law, the *Zhonghua Renmin Gongheguo Laodong Hetong Fa* (in Mandarin) has been translated in a variety of ways, including PRC Labour Contract Law, PRC Labour Contracts Law, PRC Employment Contracts Law, and so on. This article uses the expression 'Labour Contract Law' or 'the Law'. The law was adopted at the 28th Session of the Standing Committee of the Tenth National People's Congress on 29 June 2007. It will be effective from 1 January 2008.

2 The authors are engaged in a three year ARC-funded study of labour regulation in China. More detailed analyses of the Law will be produced as that study advances.

II THE NEED FOR THE LABOUR CONTRACT LAW

China's foundational law regulating the labour market is the Labour Law of 1994.³ That Law superseded various provisional instruments that had been put in place during the gradual creation of a labour market during the 1980s. The Labour Law established key norms intended to apply to employment relationships, covering matters such as labour contracts, minimum standards and dispute resolution.⁴ At the time the Labour Law was drafted, labour market transactions in China were comparatively uncomplicated, and most still occurred within the State-owned (or collectively owned) sector of the economy.⁵ The simple and sparse provisions in the Labour Law dealing with contracting would not have immediately struck legislators as inadequate, although even at this early stage initial work on a Labour Contract Law had begun.

However, since the Labour Law was enacted, a number of serious shortcomings with the regulation of labour contracting in China have become prominent and the need for a national Labour Contract Law increasingly urgent. These shortcomings have been exacerbated by the increasing complexity in employment forms. Firstly, the provisions in the Labour Law dealing with contracts focus almost entirely (but not adequately) on termination;⁶ they do not address contract formation in any detail. For example, the Labour Law has very little to say about when a labour contract comes into existence,⁷ what the default terms are, how the contract may be amended, when a contract or a contractual term is invalid⁸ or the consequences of invalidity. This deficiency undermines the standards set out in the Labour Law, since the establishment of employment relations is a precondition to the Labour Law's application.⁹

Secondly, the Labour Law does not inhibit a range of emerging contracting practices which can lead to abuse by employers. Such practices include the requirement that employees pay bonds to guarantee their continued presence and/or performance at work,¹⁰ the use of 'rolling' fixed term contracts to evade obligations which would be owed to long term staff, the insertion of restraint of trade (or non-compete) clauses which limit employees' options when they leave a firm and the imposition of terms rendering an employee responsible for training fees.

The Labour Law appears not to contemplate these practices, as it envisages employment contracts as being entered into in accordance with the principles of

3 *Zhonghua Renmin Gongheguo Laodong Fa* [Labour Law of the People's Republic of China] ('Labour Law'), passed by the National People's Congress on 5 July 1994 with effect from 1 January 1995.

4 Ying Zhu, 'Economic Reform and Labour Market Regulation in China', in Sean Cooney et al (eds), *Law and Labour Market Regulation in East Asia* (2002) 177.

5 See Toshiki Kanamori & Zhijun Zhao, *Private Sector Development in the People's Republic of China* (2004).

6 See Labour Law, arts 23-32.

7 Labour Law, arts 16-17.

8 Labour Law, art 18.

9 Labour Law, art 2.

10 Anita Chan, 'Globalization, China's Free (Read Bonded) Labour Market and the Chinese Trade Unions' (2000) 6(3-4) *Asia Pacific Business Review* 260, 261-268.

'equality, voluntariness and agreement through consultation'.¹¹ This image echoes the management structure of Chinese enterprises in the early reform period, when there was relatively little distance between management and staff. However, management are now much less likely to feel obligated to act in the interests of non-managerial employees. The contracting norms promoted by the Labour Law have become an unrealistic aspiration in a country where there are major disparities in educational levels and personal resources, and thus bargaining capacity.

Third, the Labour Law does not set out principles governing proliferating forms of non-standard employment such as labour hire and casual work, nor does it provide indicia for distinguishing between employment and other forms of engagement (such as independent contracting).

In contrast to the practice in many other jurisdictions, the absence of contractual norms in Chinese labour law cannot be addressed by drawing on general contract law. The key statute on contracting, the Contract Law of 1999, does not apply to employment contracts.¹² The Contract Law covers only relationships for services, that is, independent contracting.¹³ Since the Contract Law is inapplicable, the gaps in employment law have been filled, in part, by a profusion of legislative instruments enacted by various levels of government.¹⁴ The legal status of many of these instruments is unclear. For example, material published by the Ministry of Labour and Social Security ('MOLSS') prohibits the upfront payment of money, or the handing over of property (such as an identity card) as a guarantee of an employee's performance. However, that material is cast in the form of an opinion rather than a legal rule.¹⁵ Some local governments have enacted their own local contract laws¹⁶ and while these deal with many of the lacunae in the national legal framework, they are of course limited in their geographic scope. This has meant that there are significant inconsistencies between labour law in different parts of China, despite the fact that China is, constitutionally, a unitary state, with uniform national laws throughout the mainland area.¹⁷ Such inconsistency can be beneficial if it leads to

11 Labour Law, art 17.

12 *Zhonghua Renmin Gongheguo Hetong Fa* [Contract Law of the People's Republic of China] ('Contract Law'), passed by the National People's Congress on 15 March 1999 with effect from 1 October 1999. Article 123 of the *Contract Law* provides that 'where other laws stipulate otherwise on contracts, such provisions shall govern'.

13 Contract Law, ch 15.

14 See Randall Peerenboom, *China's Long March Toward the Rule of Law* (2002) 241-279.

15 *Laodong Bu Guanyu Guanche Zhixing Zhonghua Renmin Gongheguo Laodongfa Ruogan Wenti de Yijian* [Ministry of Labour Opinion on Certain Questions concerning the Implementation of the Labour Law of the PRC] ('1995 Opinion'), issued 4 August 1995, cl 24.

16 See, eg, *Shanghai Shi Laodong Hetong Tiaoli* [Shanghai Municipality Labour Contract Regulations], passed by Shanghai Municipality People's Congress, 15 November 2001, with effect from 1 May 2002; *Beijing Shi Laodong Hetong Guiding* [Beijing Municipality Labour Contract Regulations], issued by the Beijing Labour Bureau with effect from 1 February 2002.

17 Hong Kong, of course, is a special administrative region not subject to most national PRC laws.

legal dynamism and innovation,¹⁸ but it is less desirable if it occurs at the level of fundamental principles, as is the case with the lack of labour contracting norms.

The need for an authoritative declaration of labour contract principles having binding legal force was thus undeniable as the Labour Law entered its second decade of operation. However, while there was little dispute that a Labour Contract Law was urgently needed, there were sharp differences of opinion over what the substantive content of that law should be.

III THE DEBATE OVER THE LAW

In March 2006, the Standing Committee of China's National People's Congress published a draft Labour Contract Law on its website and asked for feedback. The level of public response was unprecedented – only debates over the content of the Constitution had elicited a greater reaction. Prominent participants in the arguments over the first official draft of the Law were international business organisations. In particular, the American Chamber of Commerce in Shanghai ('AmCham') voiced strong objections to many provisions.¹⁹ Arranged against these business groups were international NGOs and the Chinese peak trade union body, the All-China Federation of Trade Unions.²⁰

The objections of these business organisations were underlaid by an opposition to measures which would limit the capacity of corporations to structure their employment arrangements as they chose. They were couched in language commonly used in neo-liberal criticisms of 'labour market regulation'²¹ but the criticisms were not always consistent with neo-liberal economic principles. They opposed, for example, provisions requiring union or employee representative consent to changes to general working conditions,²² several draft articles requiring interpretations in favour of the employee in the event of ambiguity,²³ clauses restricting dismissals and requiring substantive severance payments,²⁴ and provisions converting short term employment to permanent employment after the passage of certain time periods.²⁵ On the other hand, and less consistent with a neo-liberal perspective, they also took exception to clauses striking down wide non-compete clauses in employment contracts.²⁶

18 Sean Cooney, 'Making Chinese Labour Law Work: The Prospects for Regulatory Innovation in the People's Republic of China' (2007) 30(4) *Fordham International Law Journal* 1050, 1081-1086.

19 David Barboza, 'China Drafts Law to Boost Unions and End Abuse', *New York Times* (New York) 13 October 2006. The European Chamber of Commerce in China, while initially opposing many aspects of the Law, appeared to mute its criticisms following internal discussions within the organisation.

20 Ibid.

21 See Letter from the American Chamber of Commerce in China to the Standing Committee of the National People's Congress, 19 April 2006 (on file with the authors).

22 Labour Contract Law, first draft, art 5.

23 Labour Contract Law, first draft, arts 9, 10.

24 Labour Contract Law, first draft, ch 4.

25 See, eg, Labour Contract Law, first draft, art 40.

26 See, eg, Labour Contract Law, first draft, art 16.

Not surprisingly, labour organisations saw these criticisms as simply designed to further business interests at the expense of workers.²⁷ The sometimes abrasive approach taken by US business lobby groups in particular,²⁸ did little to dispel this perception.

The polarisation of views in the international community had the unfortunate consequence that more nuanced perspectives and analyses of the appropriateness of the draft law's content, which might have made a positive contribution to the debates taking place within China, struggled to emerge. Sophisticated analyses of labour market regulation²⁹ suggest that both 'laissez faire' approaches (maximising employer discretion) and 'protective' approaches (imposing proscriptive rules on firms) to law-making can have deleterious consequences. As the experience in China itself suggests, failure to explicitly prohibit employers from engaging in improper practices may contribute to the prevalence of bonded labour, unilateral variation of agreed working conditions, or the arbitrary imposition of fees in order to reduce salary.

On the other hand, excessive restriction on termination of employment, or the imposition of extensive procedural requirements on firms can lead to 'creative compliance' (that is, evasion) or reduction in employment, or both. This can, despite the best intentions of the legislature, prejudice the position of employees overall. Thus, the quality of the analyses put forward by the international contributors would have been strengthened by more explicit acknowledgement of the shortcomings of their own policy presumptions. However, given the polemical nature of the submissions, it is perhaps unrealistic to expect that this could have ever occurred.

In any event, following comments from the representatives of these organisations, and other feedback, the first draft of the Labour Law was significantly modified, but not to the extent sought by some business groups. Two further drafts were prepared between late 2006 and mid-2007,³⁰ which were the subject of further discussion between various interest groups, Chinese scholars and government officials. The final draft was passed by the Standing Committee of the National People's Congress on 29 June 2007 and will take effect from 1 January 2008.

27 For a labour NGO perspective, see Global Labor Strategies, *Undue Influence: Corporations Gain Ground in Battle over China's New Labor Law* (2007); available at <http://laborstrategies.blogs.com/global_labor_strategies/files/undue_influence_global_labor_strategies.pdf> at 13 October 2007.

28 A Chinese colleague reported to us that representatives from the American Chamber of Commerce in Shanghai 'gate-crashed' a conference on the Labour Contract Law he was co-hosting in Shanghai, threatening disinvestment if the draft provisions were enacted.

29 See, eg, Hugh Collins, Paul Davies and Roger Rideout, *Legal Regulation of the Employment Relation* (2000).

30 Copies of the drafts are on file with the authors.

IV SUBSTANTIVE IMPROVEMENTS IN THE LEGAL FRAMEWORK

The Labour Contract Law is of wide application³¹ and effect. It regulates the establishment, performance, variation, and termination of labour contracts.³² In many respects, the Labour Contract Law is a distinct improvement on the legal framework regulating employment relations. As mentioned above, some provisions have been highly controversial, and these are discussed below. However, we first highlight the essential, and largely unobjectionable, improvements that remedy gaps in the current legal framework.

One of the most important improvements concerns underpayment of wages. The Labour Contract Law addresses this in two ways. First, it imposes broad obligations on employers to pay employees their remuneration on time,³³ in full (*jishi zu'e*) and in accordance with their contracts and PRC employment law.³⁴ Second, it prohibits specific strategies that employers have used to reduce their wage bill. The Law prohibits forced overtime and penalty rates for overtime must be paid in accordance with the Labour Law.³⁵ It prohibits bonded labour; an employer may not retain an employee's property or money as security.³⁶ It also prevents an employer including penalty clauses in employment contracts, except in relation to two clearly defined circumstances.³⁷

These measures stop an employer attempting to limit employee mobility through the use of financial constraints. They are highly significant given the widespread deployment of such constraints in the country.³⁸

A second set of provisions deal with problems concerning the content of contracts.³⁹ In response to the evidentiary difficulties caused by the absence of

31 Article 2 of the Labour Contract Law indicates the scope of the Law. It covers private sector and non-profit-making firms as well as governmental agencies where they 'establish a labour relationship' (*jianli laodong guanxi*).

32 The Chinese version of the Labour Contract Law uses two terms for termination; *jiechu* and *zhongzhi*. The first refers generally to termination at the initiative of either or both of the parties, and the second refers to termination through the occurrence of an event (such as bankruptcy or the expiration of a fixed-term contract).

33 This is unfortunately not defined. The Labour Law requires workers to be paid at least monthly: art 50. However, this has sometimes been implemented by employers in a way which maximises delay in payment.

34 Labour Contract Law, art 30. This article also enables an unpaid worker to apply directly to a court for an 'order to pay' (*zhifuling*). On one reading, this would enable a worker to bypass labour arbitration, which is usually a precondition for litigation. However, some Chinese labour law scholars have suggested to us that it may be that such an order could be made only if the matter was not contested by an employer. This issue may be made clearer when the Labour Dispute Settlement Law, currently in draft form, is enacted. In any case, the main remedy would appear to be administrative: the labour bureau can direct an employer to pay wages owed within a specified period, failing which the bureau can order damages at between 50 and 100 per cent of the amount outstanding: art 85.

35 Labour Contract Law, art 31.

36 Labour Contract Law, art 9.

37 Labour Contract Law, art 25. The two circumstances are non-compete obligations (discussed below) and certain training expenses (art 22).

38 They bring Chinese law closer to the position in common law countries, where a bond is unlawful unless it represents a genuine pre-estimate of loss; see, eg, *Amos v Commissioner for Main Roads* (1983) 6 IR 293.

documentation, the Law requires employment contracts to be in writing. Except in the case of casual employment (see below), where employers fail to conclude written contracts, they face liability for double wages.⁴⁰ Where written contracts are not concluded, or are invalid or vague, the Law sets out mechanisms for determining the compensation payable to, and conditions to be enjoyed by, employees.⁴¹ The pay and conditions of workers in similar positions, as well as collective contracts (from which individual agreements cannot derogate)⁴² provide relevant benchmarks.

Third, the Law deals with change in the form or nature of an employing entity. As in common law jurisdictions, a mere change in name, directorship or investor profile does not affect an employment contract.⁴³ More enigmatically, the Law provides that in the event of the merger or division of a firm or similar circumstances (*hebing huozhe fenli deng qingkuang*) the labour contract will continue to have effect in relation to the employing entity which ‘succeeds to its rights and obligations’ (*you chengxu qi quanli he yiwu de yongren danwei*).⁴⁴ This approach to transmission of employee entitlements is admittedly a straightforward solution to the employment consequences of firm restructuring. However, it glosses over the many complex issues that can occur when a firm restructures, and will require elaboration. For example, on one interpretation at least, it seems to assume, in contrast to the position in many other legal systems, that an employment contract (and the associated employment relationship) automatically transfers to the new entity, regardless of the wishes of the employee, or the new entity.

Other articles deal with discrete issues on which the Labour Law provides no guidance. For example, the Labour Contract Law stipulates standards for probationary arrangements.⁴⁵ It imposes a disclosure obligation on both parties during the hiring process, including requiring an employer to answer an employee’s questions about matters such as safety.⁴⁶ It explains when an employment relationship begins (from the day the employee performs work for the employer)⁴⁷ and when an employment contract takes effect (where consensus is reached and a written document signed).⁴⁸

V THE CONTROVERSIES

The practical reforms just discussed have not, in general, elicited the strongly opposing responses put by the various ‘pro-worker’ and ‘pro-business’ lobby

39 The Labour Contract Law replicates provisions in the Labour Law mandating the required content of labour contracts: art 17.

40 Labour Contract Law, arts 10, 82.

41 Labour Contract Law, arts 11, 18, 28.

42 Labour Contract Law, arts 18, 55.

43 Labour Contract Law, arts 33.

44 Labour Contract Law, art 34.

45 Labour Contract Law, arts 19-21.

46 Labour Contract Law, art 8.

47 Labour Contract Law, arts 7, 10.

48 Labour Contract Law, art 16.

groups. Their attention has been directed rather at the provisions mandating employee representation, regulating forms of contracting and restricting employer control over the post-employment activities of workers.

A Employer Changes to Work Rules and Employee Representation

One of the sharp differences of view has concerned the role of employee representatives in relation to variation of working conditions at the initiative of the employer. Article 4 provides that where an employer devises or makes changes to work rules which 'have a direct bearing on the interests of its workers' (*zhijie sheji laodongzhe qieshen liyi*), it must submit the rules to the employees' congress or, if there is no formal structure, to all the employees. These may then make proposals and comments (*fang'an he yijian*); these comments then lead to 'a decision through consultations with union or the workers' congress on a basis of equality' (*yu gonghui huozhe zhigong daibiao pingdeng xieshang queding*).

In the first draft of the Law, these changes required the *consent* of the employee representatives in order to take effect. It is not entirely clear what the new wording 'a decision through consultations on the basis of equality' means; it has perhaps been left deliberately ambiguous. On one view, it simply requires an employer to go through a process as employee representatives cannot veto a change. This view is supported by the fact that the Law does not specify the consequences of a failure to observe this process. It does not seem, on the face of the Law at least, that any work rules put into effect without consultation would be invalid. The remedy, if any, would come through intervention by an administrative agency.⁴⁹

On the other hand, the wording of a prior Interpretation of the Supreme People's Court would suggest that the work rules cannot be invoked by an employer in any arbitral or judicial proceeding unless they have 'been formulated through a democratic process' (*tongguo minzhu chengxu zhiding*).⁵⁰ If this Interpretation remains in place – and it does not directly contradict the wording of the Labour Contract Law – then it would seem that, at least for the purposes of external enforcement, consent is required.

In any case, even if article 4 of the Labour Contract Law does confer on employers the ability to unilaterally alter working conditions, this apparent power may well be illusory to the extent that there is overlap between the content of work rules and the content of contracts. Thus, work rules may be made with respect to remuneration, working hours, leave, and protection against

49 Similarly, article 4 goes on to enable a trade union or individual employee to indicate to the employer that the implementation of a work rule, or employer decision, is inappropriate. The rule or decision is then to be 'by making ameliorating amendments after consultation' (*tongguo xieshang yuyi xiugai wanshan*). Again, the remedy for non-observance of this provision by the employer would seem to be action by an administrative agency.

50 *Zuigao Renmin Fayuan guanyu Shenli Laodong Zhengyi Anjian Shiyong Falü Ruogan Wenti de Jieshi* [Interpretation of the Supreme People's Court Concerning Several Issues Regarding the Application of Law to the Trial of Labour Disputes Cases] (*Fashi 2001 No 14*), issued by the Supreme People's Court on 16 April 2001 with effect from 30 April 2001, art 19.

occupational hazards.⁵¹ These matters are also covered by labour contracts,⁵² including collective contracts,⁵³ the key difference being that contracts cannot be altered unilaterally. According to the Labour Contract Law, employment contracts may be amended only by consultations leading to agreement (*xieshang yizhi*).⁵⁴

The Law does not specify the relationship between rules and contracts. It states only that work rules must be consistent with ‘law and regulations’.⁵⁵ As the Law permits employees to obtain remedies for non-payment of contractually agreed compensation, the contract presumably prevails over inconsistent work rules, at least to the extent that it imposes a financial obligation.

It follows that, as in other systems where work rules are in common use, an employer has an interest in minimising restrictions in the employment contract (or collective contract) on its capacity to alter working conditions. Conversely, employees and their representatives would be well advised to specify in a contract those matters which they do not seek the employer to vary. In practice, most employment contracts in China tend to reflect state specified standards, and suggest little genuine negotiation;⁵⁶ it is ultimately the State rather than the employer or employee that will set the key terms governing the employment relationship.

B Forms of Contracting and Termination of Employment

Perhaps the most acute point of disagreement surrounding the Law concerned the interrelated questions of permissible forms of contractual engagement and termination provisions.⁵⁷ Business groups sought to reduce the costs of terminating employees, whereas worker representative organisations pushed for job security and compensation in the event of dismissal. The outcome of the debates has been a bifurcated regulatory framework, with workers engaged on a regular basis enjoying extensive protections of their tenure, while non-standard workers have little security.

The Law classifies employment relationships into four categories. Three require formal written contracts to be concluded. These three categories (which predate the Labour Contract Law, being referred to briefly in the Labour Law)⁵⁸ are: fixed term (*guding qixian laodong hetong*), continuing (*wuguding qixian laodong hetong*); and contracts for a specific task or ‘project contracts’ (*yi*

51 Labour Contract Law, art 4.

52 Labour Contract Law, art 17.

53 Labour Contract Law, art 51.

54 Labour Contract Law, art 35.

55 Labour Contract Law, art 80.

56 Zhu, above n 4.

57 For legal background to the controversy here, see Li Kungang, ‘Lun Laodong Guanxi de Wendingxing he Liudingxing – Jian lun Woguo Laodong Hetong Zhidu de Wanshan’ [A Discussion of Stability and Mobility in Labour Relations: Improving China’s Labour Contract System] (2000) 6 *Fashang Yanjiu* [Studies in Law and Business] 99; Li Kungang, ‘Guanyu Woguo Laodong hetong Zhidu Liang ge Wenti de Tanta’ [A Discussion of Two Issues concerning China’s Labour Contract System] (2000) 22 *Xiandai Faxue* [Modern Law Science] 43.

58 Labour Law, art 20.

wancheng yiding gongzuo renwu wei qixian de laodong hetong).⁵⁹ The most important distinction between the three categories is the circumstances in which they can be terminated: a fixed term contract has an agreed termination date,⁶⁰ a contract for a specific task terminates when the task is completed,⁶¹ and a continuing contract has no completion date and is terminable only for cause.⁶²

The fourth category of labour contract is an innovation, which emerged as a distinct section of the Law only at second draft stage. It is described as 'non-full-time engagement of labour' (*fei quanri zhi yonggong*), which will be referred to here as 'casual' employment.⁶³ This employment is remunerated by the hour and is terminable at any time without notice or severance pay.⁶⁴ The use of casual employment is restricted to an average of no more than four hours per day, and no more than 24 hours per week with the same employer.⁶⁵

The Law goes into some detail in stating the circumstances in which a labour contract may be terminated other than by expiration. The Law creates significant barriers to dismissal in relation to the first two categories of contracts (continuing and fixed term) and, possibly, with respect to the third. In this, China has come to resemble employment systems in East Asia and Europe, and contrasts with the position in the United States and Australia. The barriers relate both to the *circumstances* and to the *financial consequences* of dismissal.

Many of the Labour Contract Law provisions relating to the *circumstances* justifying termination for the first three categories of employment contract are a reworking and elaboration of earlier articles in the Labour Law.⁶⁶ Essentially, they stipulate four methods of termination at the instance of either, or both, of the parties; termination by consent;⁶⁷ summary termination (for misconduct, or during the probation period);⁶⁸ mass redundancy⁶⁹ and termination by 30 days notice.⁷⁰

In contrast to the common law position in jurisdictions such as Australia and the United Kingdom, termination by notice can only occur if the employer can establish one of a number of grounds. These are that the worker is incapacitated as a result of a non work-related injury, that the worker is incompetent despite training or alteration of the position, or that there is a 'major change in the objective circumstances relied upon when the contract was made' (*laodong hetong dingli shi suo yiju de keguan qingkuang fasheng zhongda bianhua*).⁷¹

59 Labour Contract Law, art 12.

60 Labour Contract Law, art 13.

61 Labour Contract Law, art 15.

62 Labour Contract Law, art 14.

63 Labour Contract Law, ch 5, s 3.

64 Labour Contract Law, arts 68, 71.

65 Labour Contract Law, art 68.

66 See Labour Law, arts 20-21, 23-29.

67 Labour Contract Law, art 36.

68 Labour Contract Law, arts 38-39.

69 Labour Contract Law, art 41 (referring to termination of 20 persons or more, or 10 per cent or more of the workforce. There are extensive substantive and procedural requirements to be followed.

70 Labour Contract Law, arts 37, 40. Wages are payable in lieu of notice. The Law does not indicate whether the notice period can be extended by agreement.

71 Labour Contract Law, art 40. This last phrase could presumably cover an individual redundancy.

There are further restrictions on termination by notice: for example; a pregnant worker or a worker suffering from a work-related injury cannot be terminated.⁷²

Apart from defining the situations in which termination is permissible, the Labour Contract Law mandates a procedural requirement. Where employment is terminated at the initiative of the employer, the employer must advise a firm's labour union of reasons for the dismissal which may object that the termination is not in accordance with the law or the labour contract.⁷³ Some tribunals have held a termination which does not comply with this requirement to be invalid.

As to the financial consequences of dismissal, the Labour Contract Law establishes a high level of severance pay, generally calculated at one month's pay per year of service.⁷⁴ This sum is payable in most cases of termination of continuing and fixed term employees, including termination by consent, termination by notice at the initiative of the employer, termination by the employee for employer misconduct, redundancy (but only if the Enterprise Bankruptcy Law applies) and termination of a fixed term contract through expiration (unless the employer offers a renewed contract on the same or superior terms).⁷⁵

The generosity of these severance arrangements may be explained in part by the inadequacy in China of State-provided unemployment insurance. In the absence of a comprehensive social welfare system, the consequences of a job loss to an individual may be very serious (assuming they are unable to find alternative employment quickly). The severance provisions represent a policy decision to require a previous employer to bear some of these costs.⁷⁶

These restrictions on, and costs associated with, termination of continuing and fixed term employment may create an incentive for employers to use short term engagements of workers. One possibility is use of the third category of formal employment, namely project contracts. This category may be attractive from an employer's point of view because, on one interpretation of the Contract Law, expiration of a specific task contract does not generate an entitlement to severance pay. This interpretation flows from fact that the severance provision refers only to 'fixed term contracts', not to project contracts.⁷⁷

Another consequence of the view that project contracts are not regulated by provisions referring only to 'fixed term contracts' is that project contracts are not subject to a 'conversion' requirement. That requirement operates upon the offer

72 Labour Contract Law, art 42. The categories of workers set out in this provision also cannot be terminated on the grounds of mass redundancy.

73 Labour Contract Law, art 43.

74 Labour Contract Law, art 47. The article contains certain exceptions to this principle.

75 Labour Contract Law, art 46. Interestingly, where large scale redundancies occur, other than as a result of restructuring under the Enterprise Bankruptcy Law, severance appears not to be payable. However, a set of priority rules apply to redundancy which would see continuing and long term workers, and workers with dependencies retained or rehired in preference to other workers.

76 While these arrangements are quite understandable given the present state of the PRC social security system, experience from India and Indonesia suggests they have the potential to have an adverse effect on employment: see Caroline Brassard and Sarthi Acharya (eds), *Labour Market Regulation and Deregulation in Asia: Experiences in Recent Decades* (2006).

77 Labour Contract Law, art 46(5).

of a third successive fixed term contract; in such circumstances, the employee can request conversion to continuing status.⁷⁸ This arrangement is clearly designed to prevent the 'rolling' use of fixed term contracts. There are no such express restrictions on the 'rolling' use of specific task contracts, until the employee has been engaged for ten years.

This means that it would, in principle, be possible to engage a worker on a long succession of short-term contracts for specific tasks. The employment relationship could be terminated without compensation when any of the contracts expired. Provided the employer had kept a paper trail evidencing the contracts,⁷⁹ there would not seem to be a general power for a judge or administrative official to deem the relationship to be in substance a continuing one.

However, many Chinese labour law scholars are of the view that project contracts are in fact a *subset* of fixed term contracts, and therefore the provisions concerning severance payments apply also to project contracts. If this is so, then project contracts are not a means of evading the severance and conversion requirements after all. Indeed, it is difficult to see why, in principle, project contracts should be treated in a fundamentally different way from fixed term contracts. The category of project contract is bounded in the same way as a fixed term contract, except that the boundary event is completion of a project, not a specific date.

The correct view is yet to be established by administrative regulation or high level court interpretation. In the absence of such an authoritative determination, it would be unwise for an employer to assume that project contracts are not subject to severance payments or conversion requirements.

Another more legally secure option to avoid the use of continuing and fixed term employment is to make extensive use of the fourth category of labour contract, which is informal in the sense of not requiring a written employment contract.⁸⁰ As mentioned earlier, this type of employment is terminable at will. The limitation in this category is the temporal restriction; it cannot be used in relation to a full time worker. Nonetheless, as this form of employment need not be evidenced by a formal contract or other documentation, it may be difficult to prove that this limit has been exceeded. In any case, it is unclear what the contractual consequence will be if the temporal limit is exceeded. For example, the Law does not specify which of the remaining three categories would apply.

Obviously, this form of engagement is very tenuous and many employers will have an incentive to use it in order to evade the termination arrangements pertaining to continuing and fixed term staff. At the time of writing, the Law had not yet come into operation and it was not clear how the contract categories were likely to operate in practice.

Nonetheless, experience in other developing Asian countries suggests that the bifurcation between (relatively) secure and precarious categories of employment will result in a substantial number of low skilled and female workers (who are

78 Labour Contract Law, art 14.

79 Where there is no written contract and the employment relationship has continued for more than one year, the relationship will be deemed to be a continuing one: Labour Contract Law, art 14.

80 Labour Contract Law, art 69.

usually more likely than men to work part time) engaged in the latter category. If this occurs, then the benefits of the Labour Contract Law will accrue predominantly to workers who are in relatively strong positions within the labour market. The limitations on costs associated with successive use of fixed term arrangements, together with the restrictions on bonds referred to earlier in this article, are likely to further strengthen their position. They may well enjoy both greater job security (since the increased costs associated with fixed term employment may encourage the use of continuing employment) and greater mobility (since their employers will not be able to forfeit their bonds on termination). This makes the Labour Contract Law's treatment of non-compete clauses (discussed below) even more significant.

C Labour Hire

One of the strongest impacts of the Law is likely to be felt in the use of labour hire or 'dispatch' (*laowu paiqian*) workers. Labour hire occurs where a firm (the user firm) has work performed by workers that it purports not to employ, but rather obtains from another firm (the labour hire firm) which 'dispatches' those workers to the user firm. Labour hire firms have proliferated in China and, as in other parts of Asia, have been the target of special legislation. The regulatory concern with labour hire is that the observation of labour standards in firms will be undermined by the displacement of regular workers by dispatch workers not subject to collective and individual contractual arrangements negotiated within the firm. Moreover, dispatch workers may be prejudiced by abrogation of responsibility for working conditions by both the labour hire agency and the user firm.

The Chinese response to labour hire as reflected in the Labour Contract Law has been quite tough.⁸¹ All dispatch workers must be engaged under fixed term contracts of a duration of not less than two years.⁸² This means that they will be in one of the more secure categories of engagement. The labour hire company must ensure that the dispatch workers receive at least the minimum wage on a monthly basis, even when they are not placed.⁸³ The arrangements between the labour hire and user firms must be governed by a formal contract detailing the placements and the payments to be made, including arrangements with respect to social insurance premiums.⁸⁴ Labour hire workers must be paid at the same rate as workers in the user firm engaged in similar work⁸⁵ and must receive the same penalty rates and benefits;⁸⁶ they may also join the user firm's union.⁸⁷ The labour hire firm cannot seek to deduct expenses from its workers as a means of reducing their remuneration.⁸⁸

81 See Labour Contract Law, pt 5, s 2.

82 Labour Contract Law, art 58.

83 Labour Contract Law, art 58.

84 Labour Contract Law, art 59.

85 Labour Contract Law, art 63.

86 Labour Contract Law, art 62. The user firm is responsible for paying the workers that it hires: art 60.

87 Labour Contract Law, art 64.

88 Labour Contract Law, art 60.

Further restrictions include: a prohibition on user firms 'on-selling' dispatch workers to other firms;⁸⁹ a requirement that labour hire be implemented generally for short-term, supplementary and substitute positions;⁹⁰ and a prohibition on employers setting up service firms to dispatch workers to themselves or their subsidiary organisations.⁹¹

Although these provisions are weaker than the original draft,⁹² they are nevertheless remarkable. In comparison with other parts of the Law, many of the articles dealing with dispatch firms are unambiguous, and establish 'bright-line' obligations, compliance with which can be readily tested. If the Law is implemented as written, there would seem to be little incentive for employers to attempt to substitute dispatch workers for their regular workforce – which is no doubt what the regulators intend to achieve – and the growth of labour hire firms may be curbed.

D Non-Compete Clauses

A fourth area of controversy concerns the capacity of an employer to restrict an employee's post-employment options. In many jurisdictions, courts and legislators have frequently refused to give effect to such post-employment restrictions, especially where they travel beyond protection of the legitimate interests of the employer and constitute an impediment to competition and/or deprive an employee of the capacity to earn a living.⁹³

In China, non-compete clauses are a recent phenomenon; the Labour Law did not attempt to regulate them specifically.⁹⁴ In contrast, the first draft of the Labour Contract Law adopted quite a stringent approach to them.⁹⁵ That draft permitted the employer to reach an agreement with the employee that the employee would not be employed by another employer, or operate a firm engaging in production or business activities similar to and competing with the employer. The employee would be liable for damages to the employer if he or she breached the agreement.⁹⁶ However, in the first draft, any such restraint could be imposed only on 'employees familiar with the employer's commercial secrets' (*zhixi qi shangye mimi*). It was limited to the territory in which there would be an actual competitive relationship (*shi jingzheng guanxi*), and it could not operate for more than two years. Moreover, the employer was obliged to pay the employee at least one year's salary for the clause to take effect.

The Law as enacted adopts a more liberal approach to non-compete clauses in three respects. First, a restriction can apparently be imposed on any employee,

89 Labour Contract Law, art 62.

90 Labour Contract Law, art 66. It is difficult to see how this could be enforced, except in the event that it is flagrantly violated.

91 Labour Contract Law, art 67.

92 They no longer provide for employer bonds or for automatic conversion to permanent status.

93 See, eg. *Buckley v Tutty* (1971) 125 CLR 353; *Woolworths Limited v Mark Konrad Olsen* [2004] NSWCA 372.

94 The Labour Law contained only a vague provision permitting clauses concerning business secrets: see Labour Law, art 22.

95 See Labour Contract Law, first draft, cl 16.

96 See Labour Contract Law, first draft, cl 16.

not just those familiar with the employer's commercial secrets. This is because an employer may bind 'high level management and technical staff' as well as 'any other personnel having a confidentiality obligation.'⁹⁷ Since the Law appears to permit an employer to include in the labour contract of *any employee* confidentiality clauses pertaining to the business secrets and intellectual property of the employer,⁹⁸ all employees could potentially be subject to a confidentiality obligation.

Second, the amount of compensation for an employee subject to a non-compete clause may now be less than originally contemplated. All that is now required is 'financial compensation on a monthly basis',⁹⁹ rather than one year's salary.

Third, the geographic restriction on competition and the reference to an 'actual competitive relationship' has been dropped, although the two year temporal restriction remains. The Law simply provides that the 'scope, territory and duration' of the restriction is a matter for agreement between the parties, although the wording of the provision suggests that the clause must at least relate to competition in the same line of products or businesses.¹⁰⁰

An important issue flowing from these provisions is whether judges would have a general discretion to strike down clauses that fell within the terms of these provisions but were nonetheless unreasonable – for example the geographic restriction applied to parts of the country where the possibility of competition was negligible. Such a discretion does not appear to exist on the face of the Law, although some scholars have suggested that it may be derived from the General Principles of the Civil Law.¹⁰¹ If there is no such discretion, then non-compete clauses may be able to impose far greater restrictions on employees in China than they can in other jurisdictions.

It may be concluded that the apparent outcome for business groups in relation to non-compete clauses is more favourable than in the case of labour hire.

VI CONCLUSION

Chinese labour law has proved to be a matter of the keenest interest not only for domestic regulators and stakeholders, but also for powerful interest groups based in developed nations. The final draft of the Labour Contract Law plainly represents an attempt to reconcile the demands of these competing voices. It attests to the increased openness of the Chinese legislative process to a wide variety of external influences. The end product of the debates, while bearing the hallmark of uneasy compromises, is a clear improvement on the legal position that prevailed prior to its enactment.

97 Labour Contract Law, art 24.

98 Labour Contract Law, art 23.

99 Labour Contract Law, art 24.

100 Labour Contract Law, art 24.

101 *Zhonghua Renmin Gongheguo Minfa Tongze* [General Principles of the Civil Law of the People's Republic of China], adopted at the Fourth Session of the Sixth National People's Congress, promulgated on 12 April 1986, and effective as of 1 January 1987.

Certainly, a number of possible shortcomings and uncertainties in the Law have been identified, although this article has not attempted to provide an exhaustive analysis. There are several issues not addressed in this article that clearly merit close examination. One is the approach to enforcement reflected in the Law.¹⁰² This approach – one which characterises much Chinese regulation – places great reliance on the administrative agencies to secure compliance with the Law, at the expense of dispute resolution processes and courts in particular. There are significant shortcomings with this ‘command and control’ style of enforcement.¹⁰³ Moreover, and again like many other Chinese statutes, some obligations seem to have no correlative remedial or penalty provisions.¹⁰⁴ The authors propose to analyse these matters in a subsequent article.

A further question concerns the scope of the Labour Contract Law. For example, it does not attempt to provide criteria for distinguishing between labour relationships and other forms of work relations and thus fails to resolve classification problems existing at the border of employment and independent contracting. In the absence of such criteria, unscrupulous employers may be tempted to enter into sham arrangements with workers, so that employees are denied the benefits of the Labour Contract Law and other labour legislation, through being classified as independent contractors.

Nevertheless, in providing much clearer guidance to the parties to employment relationships, as well as to administrators, labour arbitrators and judges, the Law makes a contribution to addressing some of the egregious abuses that occur in China. There is now a much better system of norms, having the status of national law, dealing with disputes over issues such as wage payments, termination and labour hire. While it does not on its own solve the compliance problems that plague Chinese labour law, it goes a long way towards clarifying which rules should be followed.

102 Labour Contract Law, chs 6-7 deal with enforcement measures.

103 See Cooney, above n 18.

104 See, eg, Labour Contract Law, art 4.