



## FDI in China Series Employment Contract Basics

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*China's employment system centers on the term-based employment contract (as opposed to at-will employment, in which the employment relationship can be terminated at any time). Given the relative stringency of the term-based employment system, as well as the propensity for the dispute resolution system to rule in favor of employees in employment claims, China-based employers benefit from developing a compliant and balanced employment framework.*

*This primer explores the various employment types available in China, with a focus on strategies to achieve balance in the most prevalent framework, the fixed-term employment contract.*

### Recruitment Advertisement

A sound employment strategy in China begins with careful consideration of the recruitment advertisement. An employee's failure to meet the requirements in the recruitment advertisement is grounds for immediate termination during the probation period (which is one of the least restrictive periods for an employer to terminate an employment relationship). Thus, care must be taken to ensure that the recruitment advertisement clearly and specifically states the requirements for the person filling the position, in anticipation of the potential need to terminate an employee who does not meet such requirements.

### Written Employment Contract

The employer should enter into a written employment contract with the employee within one month of the employee starting work. If the employer fails to do so, then it risks several regulatory consequences (e.g., double salary fine for up to 11 months, default establishment of an open-ended employment contract).

### Employment Contracts Types

According to labor law, fulltime employees may be contractually engaged through one the following contract types:

- (i) Fixed-term employment contract – An employment contract in which the expiration date is fixed to a specific date.
- (ii) Open-ended employment contract – An employment contract in which there is no expiration date.  
  
An open-ended employment contract is required if (a) the employee has worked for the employer fulltime for ten uninterrupted years, or (b) the employer and employee have concluded two fixed-term employment contracts and enter into a third employment contract, or (c) the employer fails to enter into a written employment contract with the employee for one year from the first day of employment.
- (iii) Project-based employment contract – An employment contract in which the expiration date is linked to conclusion of a project for which the employee is engaged.

Other contracts used to engage workers are:

- (i) Personal services contract – A contract in which the worker uses his own facilities and equipment to complete a service, and is not required to follow company policies or work particular hours. The company is not required to pay social insurance or severance because a personal services contract is not an employment contract.

Companies opting for personal service contracts must ensure that they meet the relevant criteria or face the risk that the personal services contract is deemed a de facto

employment contract, invoking additional wages, taxes, social insurance fees, and fines.

- (ii) Part time employment – No contract is needed, and either party can terminate the relationship immediately. Additionally, social insurance contributions may not be required. Remuneration is calculated on an hourly basis and working hours may not exceed daily and weekly ceilings. Care must be taken to ensure that the employee does not exceed the daily or weekly ceilings, or a de facto employment contract may be formed, giving rise to additional wages, taxes, social insurance fees and fines.
- (iii) Dispatch employment – Under this scenario, a dispatching company enters into an employment contract with the worker, dispatching (or seconding) the worker to the company. The company and the dispatching company enter into a corresponding service agreement .

Many companies use this structure in order to avoid the legal risks arising from an employment relationship. However, in practice, dispatching companies often seek deeply one-sided service agreements that shift an inordinate amount of risk to the company. The company should read the service agreement closely and prepare for a tough negotiating process .

### Provisions

The employment contract must include certain provisions in accordance with law, including (but not limited to) the remuneration, work address, job title and work hours. The employment contract may also include additional company-specific provisions to govern the employment relationship. The employment contract provisions below can go far to create a robust framework for a healthy employment relationship.

#### Probation period

The probation period provides a window of time during which the employer can assess the employee, and the employer may dismiss the employee without severance at any time during the probation period if the employee does not meet the recruitment advertisement requirements. The probation period occurs at the beginning of the employment contract term and can last for a period up to six months (depending on the length of the contract term).

#### Training

If the employer incurs out-of-pocket expenses to train an employee (e.g., airfare, external trainers (including managers from an affiliated company)), the employee can be required to reimburse the employer if such employee separates from the employer prior to the end of the contract term. This structure may



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enable the employee to understand the value of This structure may enable the employee to understand the value of the training, and may mitigate the risk of an employee separating from the employer prior providing a return on the training costs.

### *Detailed job description*

A detailed job description is essential to establish the employer's expectations for the employee, in addition to forming the basis for any decision to terminate an employee for poor job performance. As such, it is advisable for an employment contract to include an appendix with a detailed job description that sets out not only the employee's duties, but also the professional standards for executing such duties. Additionally, the employment contract may state that the employer may vary the position according to its needs.

### *Confidentiality*

It is advisable for the employment contract to define information (e.g., trade secrets, intellectual property, clients) that is considered confidential, and to prohibit the employee from using or divulging such confidential information.

### *Competition prohibition*

The employment contract may include a competition prohibition, which may apply during the employment contract term and/or after the termination or expiration of the employment contract term. If the competition prohibition applies after the termination or expiration of the employment contract term, the employer should compensate the employee for the duration of the competition prohibition in order for the prohibition to be effective.

### *Fiduciary duty*

The employment contract may obligate the employee to fulfill his or her fiduciary duty towards the employer, by establishing that the employee has an obligation to act in the best interests of the employer.

### **Employee Handbook**

While not required by law, the employee handbook can serve as a supplement to the employment contract to clearly describe company policies. Employers should utilize the employee handbook as a means of explicitly communicating its expectations and employee obligations, particularly on sensitive subjects (e.g., overtime, disciplinary action, expense reimbursement) that may be the source of disputes. A well-drafted employee handbook that clearly specifies rules and policies can be an important resource for legitimately disciplining or dismissing an employee on the grounds that he has not complied with the employer's policies.

### **Ending the Employment Contract**

In general, an employment contract may end through one of the four mechanisms below (of which the first three are straightforward).

#### *Expiration of the employment term*

A fixed-term employment contract ends after the expiration of the employment term set out in the employment contract, and the employer is not obligated to enter into a new employment

contract upon expiration. Note that after two consecutive fixed-term employment contract, the third employment contract will automatically become an open-ended employment contract by default and will not expire.

#### *Mutual agreement*

An employment contract may end if the employer and employee reach a mutual agreement regarding termination and severance. The employer should take care to document such mutual agreement to prevent a claim of wrongful termination.

#### *Employee registration*

The employee may resign, thereby ending the employment contract, by giving 30 days notice or by immediately resigning if the employer is in breach of the employment contract. Unfortunately, there are no significant mechanisms available in relevant provisions to encourage compliance with such notice.

#### *Employer termination*

Under limited circumstances, an employer may terminate the employment contract with either 30 days notice or no notice at all, depending on the circumstances.

In order to terminate the employment contract with 30 days notice, the employer must demonstrate that the employee meets one of the specific conditions which include (but are not limited to) the employee remaining absent after exceeding medical leave, the employee's inability to perform her duties after receiving training or being transferred to another position, an event of force majeure to the company, or a significant change in the objective conditions on which the employment contract was based (e.g., restructuring due to a merger).

In order to terminate the employment contract immediately, the employer must demonstrate that the employee meets one of the specific conditions for immediate termination, which include (but are not limited to) working for another employer in violation of instructions not to, under prosecution or found guilty of a crime, or serious dereliction of duty and/or graft causing substantial damage to the employer.

Bear in mind that when the employer is initiating termination, there is an extremely heavy burden of proof placed on the employer; it is for this reason that the recruitment advertisement, employment contract (including a detailed job description), employee handbook, written warning notices, etc. require great care.

### **Other Employment Issues**

In addition to the employment concepts set out above, employers in China should be aware of a host of related issues that together shape the employment system (e.g., labor arbitration, social insurance, individual income tax, overtime, severance, irregular work hours, discipline records, labor unions, work permits, work conditions, holiday and leave).

### **Learn More**

This article is part of an ongoing series on foreign direct investment in China. To access the series or to learn more visit [www.chinasolutionsllc.com/cs-alerts](http://www.chinasolutionsllc.com/cs-alerts) or contact Nestor Gounaris at [info@chinasolutionsllc.com](mailto:info@chinasolutionsllc.com).