

How to Properly Terminate an Employment Contract in China

As a Chinese labor law practitioner, I've always been approached by my clients, either local or international, with the same question: how can an employment contract in China be legally terminated? Both employers and employees can be faced with such a difficult situation.

I've been thinking of providing my clients with a quick-and-dirty but workable roadmap (see Annex 1) they may follow in employment contract termination cases. This will in no way replace professional counseling; however it may serve as a kind of general and practical guide for those who have limited knowledge or experience concerning Chinese labor law.

1. Termination upon Expiration

When an employer contemplates to terminate the employment contract of an employee, the first question the employer should ask is if the term of the employment contract is about to expire or not. In the case of the first fixed-term¹ employment contract and such term is about to expire, the employer has the right not to renew the employment contract upon expiration; however, it shall pay economic compensation (hereinafter the "severance") to the employee. If the term does not expire, then the employer has to deal with a case of early termination.

2. Termination upon Mutual Agreement

In the case of an early termination, the employer may seek to reach an agreement on termination with the employee. If it manages to do so, it will also achieve the goal of termination of the employment contract, but, of course, with severance payment.

It should be noted that this route of termination can be a catch-all solution for an early termination, in case a unilateral termination (see below) is legally flawed and thus may not be feasible.

The employer and the employee have to reach agreement on the termination as well as on the amount of severance payment by the employer. It is normal that such an agreement can only be reached after several rounds of negotiation, depending on the specific circumstances of the case, the bargaining power of each side as well as the negotiation tactics of the two parties. As the Chinese labor law sets the maximum compensation at twice of the legal severance payment in case of wrongful termination, the finally agreed severance payment will normally fall somewhere between the minimum legal severance and the maximum compensation allowed by the law. In

¹ According to the current Chinese labor law, upon expiration of the second fixed-term contract and if the employee raises the request to sign a new open-ended employment contract, the employer will have no other option to accept such a request.

case the amount of the severance payment was already agreed upon in the original employment contract, the Chinese courts may also recognize such previously-agreed severance.

3. Unilateral Termination

3.1 Unilateral Termination by the Employer

If the employer does not have the luck to reach a termination agreement with the employee, then it will be faced with a case of unilateral termination, i.e., terminating the employment contract unilaterally by the employer.

The Chinese labor law does not give the employer the liberty to freely terminate the employment contracts of its employees by its own. The employer has to rely on at least one of the few specified circumstances under which the Chinese labor law allows it to unilaterally terminate the employment contracts with the employees.

The first circumstance that the employer may rely on is fault or misconduct committed by an employee. Such faults or misconducts of the employee are listed by the law as follows:

- Proven not qualified during probation;
- Has seriously violated the rules and policies of the employer;
- Has committed gross negligence of duties, embezzlement, seeking personal benefits at the expense of the employer and thus causing serious damages to the employer;
- Concurrent employment with another employer without agreement by the current employer, which has seriously affected his/her performance of duty with the current employer;
- The employment contract was signed by fraud or under duress; and
- The employee has been under criminal charges.

If the employer has sufficient evidence that the employee's act has fallen under one of the above categories of faults or misconducts, it may immediately terminate the employment contract without any severance payment.

Unfortunately, the employer will not be able, in most cases, to find faults or misconducts with the employee, based on which termination will be considered as legal. Then, the employer should verify if the employee is qualified for one of the following three circumstances:

- (1) The employee is ill or has non-work-related injury and is not able to resume his/her original duty or to take on another position offered by the employer.

This means that the employer shall wait until the expiration of the legal medical treatment period in order to terminate the employment contract of such a sick or injured employee. The legal medical treatment period differs from employee to employee according to their service years with the current employer and also based on their total service years since their first job. The table below provides a summary of the calculation of the length of the legal medical treatment period:

Total work Years	Work Years with current employer (Y)	Sick leave (M)	Sick leave can be taken in a continuous period of (M)
<10 years	<5 years	3	6
<10 years	≥5 years	6	12
≥10 years	<5 years	6	12
≥10 years	5 years ≤ Y < 10 years	9	15
≥10 years	10 years ≤ Y < 15 years	12	18
≥10 years	15 years ≤ Y < 20 years	18	24
≥10 years	≥20 years	24	30

Upon the expiration of the legal medical treatment period, the termination will not be automatic, because the employer is requested to organize an appraisal of the labor capability and the degree of disability of the employee. If the degree of disability is assessed as at Degree 1 to Degree 4, the employee is entitled to retire and receive monthly pension and other social insurances from the government; if the degree of disability is assessed as at Degree 5 to Degree 10, the employer is permitted to terminate the employment contract of the employee; however, in addition to the standard legal severance payment, it shall also pay to the employee a lump-sum medical treatment subsidy which may equal to 6 to 12 months of the salary of the employee.

(2) The employee is incompetent for his duty and remains incompetent after receiving training or being transferred to another position

In order to rely on this as the legal ground to terminate the employment contract of an employee, the employer should first ensure that there are objective standards or criteria to assess if the employee is competent or not for his current position. It is better to have a detailed job description for the position or clearly-defined periodic or quantifiable targets. Without such “objective” appraisal benchmarks, the employer will have difficulty in proving the incompetence of the employee.

The law further limits the employer’s freedom to terminate the employment contract even if it is able to prove that the employee is incompetent. The employer shall follow certain procedural requirements, i.e., only after providing training or putting the employee in another position and the employee is proven still incompetent that the

employer can terminate the employment contract, but, of course, with severance payment.

Very often the employer has the difficulty to apply this as the legal ground for termination, because strictly speaking, putting the employee in another position requires his/her agreement as this constitutes an amendment to his/her original employment contract. Without such an agreement, the effort of changing the current position of the employee may be considered as illegal. It is even more true in the case of management staff and senior executives.

(3) There has been material change of the objective circumstances based on which the employment contract was entered and such change has resulted in the inability to continue with the performance of the original employment contract by the employee and no agreement between the two parties can be reached as to amendment to the terms and conditions of the original employment contract.

It is more commonly referred to as “economic layoff”. The current law provides a very narrowly-defined scope for “material change of the objective circumstances”. It refers to only “event of *force majeure* or other circumstances resulting in the inability to perform the entire or the partial contract, e.g., involuntary relocation of the company, close down of the production lines, mergers and acquisitions and important assets sales, etc.

If such material change not only affects one single employee but also triggers the termination of the employment contract of at least 20 employees or 10% of the total headcount of the employer, then the employer is also required to follow the compulsory procedure of consulting and negotiating at least 30 days in advance with the trade union or the employee representatives and of filing a report at the local employment authorities.

To summarize, if the employer cannot satisfy one of the above three legally-prescribed circumstances, it will not be legally safe for it to terminate unilaterally the employment contracts of its employees.

Please also note that, even if the employer satisfies one of the above three legally-prescribed circumstances, the following circumstances are listed in the law as the legal “stoppers” to termination:

- The employee is suspected of having occupational diseases and waiting for diagnosis;
- The employee has completely or partially lost labor capability due to

- occupational disease or work injury²;
- The employee is still in the legal medical treatment period for non-work-related illness/ injury;
- The employee is pregnant, on maternity leave or in nursing period; and
- The employee has continuously worked for the employer for more than 15 years and is only less than 5 years before retirement.

3.2 Unilateral Termination by the Employee

A unilateral termination of the employment contract may also be initiated by the employee.

If the employee is able to find any fault or misconduct as listed below and committed by his employer, he/she will have the right to immediately terminate the employment contract and request the employer to pay the legal severance for termination:

- The employer has not provided the basic health protection or labor conditions;
- The employer has not paid salaries in time or in sufficient amount;
- The employer has not contributed to social insurances in time or in sufficient amount;
- The rules and policies of the employer have violated laws to the detriment of the rights and interests of the employee;
- The employment contract was signed by fraud or under duress; and
- Other faults as recognized by the law.

If the employee is unable to find any fault or misconduct with his employer, the termination of the employment contract initiated by him/her can only take the form of voluntary resignation with a 30-day prior notice, for which he/she will not be entitled to the legal severance payment.

4. Calculation of the Severance

To understand how the severance is calculated, it is simple to bear in mind the general principle that severance is calculated as 1 month salary for each year the employee has served for the employer. However, there are a few deviations or minor tuning to this general rule.

First, as the Chinese labor contract law was promulgated only on January 1, 2008, severance calculation is subject to different rules before and after this date. This

² Termination subject to special process.

means, for an employee whose employment with the current employer started before January 1, 2008, his/her severance should be calculated separately for the service period before and after January 1, 2008.

The major differences are:

- (1) Before January 1, 2008, an employee with a service period less than 12 months was entitled to a whole month salary as severance; however, after January 1, 2008, an employee with a service period less than 6 months is entitled to 0.5 month salary as severance and an employee with a service period more than 6 months but less than 12 months is entitled to 1 whole month salary as severance.
- (2) Before January 1, 2008, the amount of the monthly salary used for calculation of the severance was the actual monthly salary of the employee before the termination; however, after January 1, 2008, if the employee's actual monthly salary is higher than 3 times of the social average monthly salary³, his/her monthly salary used to calculate the severance will be capped at such 3 times of the social average monthly salary.
- (3) In addition to the cap on the monthly salary, the number of the service years used as the multiplier to calculate the severance may also be capped. Before January 1, 2008, the number of the service years was capped at 12 when calculating the severance in the case of termination upon mutual agreement or due to the incompetence of the employee. After January 1, 2008, the number of the service years are capped according to a different criterion, i.e., only the service years of the employee whose actual monthly salary is higher than 3 times of the monthly average social salary is capped at 12 years.
- (4) It should also be noted that when calculating the severance, any cash payment to the employee by the employer in the name of allowances, subsidies, benefits, etc., averaged on a 12-month period and on which the employee paid individual income tax, should be added to his/her monthly salary as the base for calculating the severance.

5. Issues Often Crop out at Termination

To make things more complicated, the following issues often crop out at the time of termination and are intertwined with the legality of termination and the calculation or negotiation of the severance payment, thus giving more headaches to the two parties:

- (1) There is no signed written employment contract: in such a case, the employer may be subject to double salary payment to the employee and the contract term may be

³ The social average monthly salary of each province is published by the authority every year.

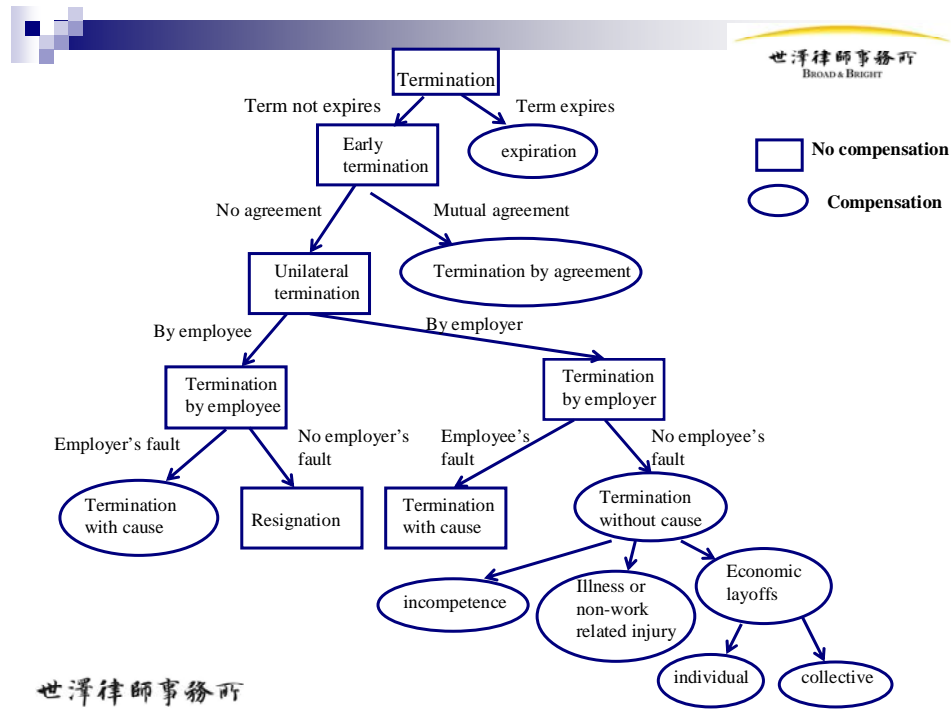
regarded as open-ended.

- (2) Unpaid or underpaid salary, overtime payment or social insurance contributions: in proven cases, the employer will not only be requested to compensate the employees for such unpaid or underpaid salary, overtime payment or social insurance contributions, it may also be subject to regulatory sanctions or penalties imposed by the relevant Chinese authorities. The employer should therefore care about its labor law compliance status in its business operation in China.
- (3) The employer may also need to think about if it wishes to impose a non-competition obligation against the employee whose employment contract is to be terminated. If there is a need for such a non-competition restriction, the employer shall reach agreement with the employee on the scope, the length of and the proper compensation for such non-competition obligation. Without proper compensation for the employee, such obligation will not be enforceable at the Chinese court.

To conclude, termination of the employment contract is never a pleasant experience for either side, i.e., the employer or the employee. The most important thing for the employer is to put aside any personal or subjective feeling or prejudice over the relevant employee and to seek an “objective” and legal ground under the Chinese labor law for the termination. Employment issues are also heavily regulated at the local level and the employer should therefore also keep in mind any difference or nuance in the regulations and employment policies of the locality of their business operation. In reality, most termination cases end up via mutual agreement, so as to avoid the lengthy and costly arbitration or litigation processes.

This article does not constitute an attorney advice. If you wish to learn more about the subject matter discussed in the article, please contact Ms. Jenny Zhong, partner and attorney-at-law at Broad & Bright Law Firm: jie_zhong@broadbright.com, Tel:8610-85131818, website: www.broadbright.com.

Annex 1: Roadmap of Employment Contract Termination



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