

Termination of employment contracts - an introduction to the legal issues

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Introduction

- As in any jurisdiction, termination of employment in PRC is a sensitive and complex issue
- High employee turnover rates in PRC – especially for senior employees
- Important to understand laws and regulations relating to termination and protection of confidential information
- Employers should take suitable measures in relation to termination - both legal and practical



Automatic termination

- Employment contract will terminate automatically
 - upon its expiry – in the case of a fixed term contract
 - when an agreed condition for termination arises
- If employee has worked for the same employer for 10 years – he/she may require an open term employment contract

Termination by agreement

- Employment contract may be terminated by unanimous agreement of the parties

Termination by employer (1)

- Termination with 30 days' notice and compensation (*Articles 26 and 27, PRC Labour Law*):-
 - non-work-related injuries and where the employee cannot engage in his/her original job or other job arranged by employer following medical treatment
 - employee is incapable to do a job and remains incapable after receiving training or transfer to other job
 - "major change" in the basis upon which the employment contract was entered into renders such employment contract incapable of being carried out and parties cannot agree on modification
 - "genuine" downsizing of employer - having consulted with relevant labour union

Economic compensation (1)

- Economic compensation equal to one month's salary for each year (or part year) of service up to maximum of twelve months' salary
- Additional medical subsidy in event of termination due to non-work-related injury - minimum of six months' salary
 - if "serious" - further 50% of medical subsidy
 - if "terminal" - further 100% of medical subsidy

Economic compensation (2)

- Economic compensation payable if termination is by agreement
- No compensation upon expiry of employment contract
- Payment should be paid promptly in one instalment – 50% penalty for delay in payment

Termination by employer (2)

- Termination without notice or compensation (*Article 32, PRC Labour Law*):-
 - if employee not up to required standard during probation period
 - if employee seriously violates labour discipline or rules of employer
 - if employee causes great loss to the employer due to serious dereliction of duty or engagement in malpractice for selfish gain
 - if employee is convicted of a criminal offence

Termination by employer (3)

- Employer may not terminate employment
 - in the case of work-related injury or illness
 - during medical treatment period
 - where employee is pregnant or breastfeeding

Termination by employee

- Employee may terminate employment contract with 30 days' notice (*Article 31, PRC Labour Law*)
- Employee may terminate employment contract at any time (*Article 32, PRC Labour Law*)
 - during the probation period
 - if employer uses violence, threats or illegal restrictions of personal freedom
 - if employer fails to pay wages or provide working conditions as agreed

Unlawful termination

- Employer shall be liable to compensate employee for damages arising from unlawful termination
- Employee shall be liable to compensate employer for breach of employment contract arising from early termination
 - difficult to prove damages
 - penalty clauses must be reasonable and reflect actual losses - e.g. training fees, relocation costs and so forth

Protection of confidential information

By contract (1)

- Employment contract may contain confidentiality provisions (*Article 22, PRC Labour Law*)
- Employee who breaches the terms of such confidentiality provisions is liable for any losses suffered by employer as a result (*Article 102, PRC Labour Law*)
- Confidentiality requirement may, if agreed, extend beyond term of employment contract, but:-
 - must be reasonable/fair in scope/term
 - additional compensation by employer may be required in some places! (e.g. Shenzhen)

Protection of confidential information

By contract (2)

- Important to define confidential information clearly and manner in which it may be disclosed
- But very difficult to prove breach and resulting damage!
- Employee dealing with confidential information may be reassigned to a different position with employer no more than six months prior to expiry of his/her employment contract or after employee provides notice of resignation

Protection of confidential information

Under the *Anti-Unfair Competition Law (1993)*

- "Trade secrets" may be protected as of right
- "Trade secret" - both technical and commercial information - which:-
 - is unknown to the general public
 - is capable of bringing actual or potential economic benefits to its proprietor
 - has practical utility
 - practical measures have been taken to protect

Protection of confidential information

- Trade secrets include:-

"Designs, procedures, product formulae, manufacturing processes, manufacturing methods, management know-how, customer lists, information on suppliers of goods, production and marketing strategies, base numbers and tender contents in the invitations and submission of tenders"

Protection of confidential information

Prohibited activities (1)

- Following activities prohibited:-
 - obtaining trade secrets of others by theft, enticement, duress and other unfair means
 - divulging, using or allowing others to use trade secrets obtained as a result of the above methods
 - divulging, using or allowing others to use trade secrets in breach of any confidentiality agreement

Protection of confidential information

Prohibited activities (2)

- Third party (e.g. new employer!) is prohibited from obtaining, using or divulging the trade secrets of others that it knows or ought to have known have been obtained by the above methods
- Employee and new employer jointly liable – new employer's share of liability not less than 70% of damages suffered!

Protection of trade secrets

Remedies (1)

- Administrative remedies
 - proprietor may file a complaint with the relevant Administrative Bureau for Industry and Commerce (AIC) - AIC has powers to (i) order infringer to cease infringement and return any relevant materials, (ii) supervise destruction of products made using the trade secrets, (iii) impose of fine of between RMG10,000 - RMB200,000
 - AIC has no power to order infringer to pay compensation!

Protection of trade secrets

Remedies (2)

- Civil remedies
 - proprietor may commence civil proceedings within two years of date it knew (or ought to have known) of infringement - burden of proof lies on the plaintiff
 - risk of further exposure of trade secrets - possible to apply to have case heard in closed court - and evidence containing trade secret need not be presented to defendant

Protection of trade secrets

Remedies (3)

- Court may order that defendant:-
 - pays damages equal to actual losses suffered or profits earned
 - ceases from infringing act
 - delivers up infringing documents
 - keeps the Trade Secrets confidential
 - makes a public apology

Protection of trade secrets

Remedies (4)

- Criminal remedies
 - proprietor may file complaint with Public Security Bureau
 - infringement amounts to a crime if the criminal act causes "serious losses" or "extremely serious" losses (yet to be defined)

Protection of trade secrets

Remedies (5)

- Penalties

- "Serious cases" - up to 3 years' imprisonment and fine
- "Extremely serious cases" - up to 7 years' imprisonment and fine

Non-competition

General principle (1)

- Non-compete principle exists under by PRC law (*Article 2, Notice Regarding Certain Questions relating to the Mobility of Employees 1996*):-
"An employer may require an employee who possesses trade secrets not to take a position with another competitor which produces the same kind of products or engages in the same kind of business or otherwise does the same thing within a period of 3 years after the expiration or termination of the employment contract"

Non-competition

General principle (2)

- The above principle is enshrined in many local-level regulations (e.g. in Shanghai, Zhuhai, Shenzhen, Suzhou, etc.)

Non-competition Restrictions (1)

- Violates principle of "freedom to work" and public policy - must be fair and reasonable
- Time limit - no more than 3 years (note 5 years under Zhuhai regulations)
- Anti-competitive activities - limited to working for competitors or oneself - do not include investing in competitor, poaching employees/customers/suppliers, etc.

Non-competition Restrictions (2)

- Additional consideration payable!
 - National regulations – silent on amount
 - Shanghai regulations – silent on amount
 - Shenzhen regulations - two-thirds of salary
 - Zhuhai regulations - half of salary
- Non-compete agreement may need to be registered (e.g. in Shenzhen)

Practical measures for employers

- Comprehensive employment contracts containing clear terms relating to termination, confidentiality, non-compete and so forth
- Adopt a Staff Code of Conduct or Employees Handbook - set out clearly items relating to staff discipline, termination procedures, etc.

Practical measures for employers (2)

- Take proactive measures to protect trade secrets (limited access, separation of documents, keep under "lock and key", mark as "confidential", etc.
- Require employee to sign statement that his/her previous employment has been terminated and that he/she is not in possession of any trade secrets of former employer
- Sign termination agreement

Practical measures for employers (3)

- Above all - good HR management!

The end

Any questions?



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