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Investing In China: Proposed Labor Contract Law

By David Carnes

If you are considering setting up a company in the People's Republic of China (the "PRC") you

should be aware that Chinese law is more protective of employees than the laws of many western nations, particularly the United States. The current PRC Labor Law was enacted in 1994; however, a new PRC Labor Contract Law, intended to supplement the Labor Law, is expected to come into force at the end of 2006. This new law contains both bad news and good news from the point of view of the foreign investor; however, in general it further strengthens the protection of employees.

The Bad News:

Severance Pay

Because it is difficult under the PRC Labor Law to terminate open-term labor contracts, employers usually prefer fixed terms. The Labor Contract Law will address this issue by requiring employers to pay severance compensation to employees on fixed term labor contracts if these contracts are not renewed at the end of the contract term. The proposed compensation is at least one month's salary for each year of service.

Company Rules/Employee Handbooks

No provision in the employee handbook or other rules affecting the employee's "personal interest" may be put into force absent consultation with the labor union or other employee representative body (under Chinese law, virtually all employees are required to be unionized).

A Shorter Probationary Period

Currently, the probationary period may be agreed between the employer and employee in the labor contract, but the maximum probation may not exceed 6 months. The Labor Contract Law shortens this period to one month for non-technical work and two months for most technical work (the six-month maximum is still retained for "senior technical work", probably because these highly skilled employees are seen as less vulnerable in the employment market. This is significant because it easier to fire an

employee during the probationary period than afterwards.

Non-Competition Clauses

Foreign invested companies in particular have tended to insert post-employment non-competition clauses into labor contracts in order to protect their intellectual property rights in China's "wild west" business atmosphere. Although the Labor Contract Law allows post-employment non-competition restrictions, it will limit their enforceability to two years and restrict the geographical area of applicability to areas where actual competition is likely to occur. In this respect the reform will render Chinese law more similar to US law, since the current Labor Law does not impose any geographic restrictions at all (but does permit a maximum duration of up to three years). The Labor Contract Law goes even further, however, by requiring the employer "buy" a non-competition clause by paying a minimum compensation equal to the employee's annual salary upon termination of the labor contract. It is still unclear what, if any compensation will be due the employee if the period of restriction is less than a year.

Contract Interpretation

Any ambiguous term in a labor contract will be construed in favor of the employee. This rule does little more than codify what has long been the prevailing practice in PRC courts.

Representative Offices

The current Labor Law requires Representative Offices to go through designated agencies such as FESCO (similar to Manpower in the United States) in order to hire employees. The new Labor Contract Law offers Representative Offices greater flexibility by allowing them to directly contract with employees for their first year of employment.

In summary, the new Labor Law will restrict foreign investor's flexibility and make it more expensive for them to operate. The only good news is that Representative Offices will find it somewhat easier to operate. Typically, the new Labor Contract Law does not bother to define terms like "technical", "senior technical"; and "personal interest" However, foreign investors have long been used to waiting months and even years for ambiguous terms in Chinese law to be defined through the further issuance of "implementing regulations" to supplement the main law; meanwhile the government's actual implementation of the law in particular cases will be closely watched.

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<http://www.chinacompanystartupguide.com>

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Investing In China: Hiring, Firing And Labor Law

By David Carnes

One of China's major attractions for foreign investors is its low labor costs. In the central provinces entry-level laborers can be hired for as little as US\$60 per month and college graduates work for as little as US\$150 per month, although labor costs in the more affluent coastal provinces are about three times as high. Furthermore, because there is a shortage of skilled labor and white collar management in the coastal provinces, additional incentives might be required to attract highly qualified employees (this is not so much of a problem in the central and western provinces). Employers can be recruited and hired directly in most cases, although there are many public and private employment agencies that will assist the foreign investor in recruiting qualified staff. In joint ventures, the Chinese partner is usually responsible for recruitment, although this is something that can be negotiated between the parties.

Employment law in China is in some ways more protective of employees than US labor law. Labor matters in China are generally governed by the P.R.C. Employment Law (although certain other national legislation also provides guidance). Where national law is silent, provincial and local laws apply, but in the event of a conflict between provincial/local laws and the Employment Law, the Employment Law prevails, much in the way as federal law trumps state law in the US.

Employment contracts are generally required and normally stipulate probation periods of no more than six months. A thirty-day advance notice and good cause are normally required in order to fire an employee after the expiration of the probation period (although employee incompetence and company business reverses considered good cause subject to certain restrictions). An employee can be immediately fired for serious misconduct.

The eight-hour workday and the forty-hour workweek are standard for blue collar employees, overtime pay is mandated by law, and there are legal limitations on how much overtime can be required. Paid leave is also required, although the required length varies according to local regulations (usually not exceeding two weeks per year). There are special protections on the type of labor that can be assigned to women and teenagers, and the minimum working age is 16. None of this should be unfamiliar to those familiar with prevailing US labor practices.

Nevertheless, Chinese labor law does include certain unique features that foreign investors should be aware of:

(1) In the event of a labor dispute, arbitration is required before the case can be taken to court.

(2) There are three funds to which both employer and employee must contribute:

1. Endowment Insurance (a kind of social welfare fund) - the employee contributes 5% of his salary, employer pays an amount equal to about one-fourth of the employee's salary (amounts vary by locality).

2. Unemployment Insurance - the employee pays 1.0%, employer pays 2.0%.

3. Hospitalization Insurance - Employee pays 2.0%, employer pays 8.0 %.

In each of the foregoing cases, the employer deducts the employee portion from the employee's paycheck, but must pay the employer's portion out of its own pocket in addition to the employee's regular wages. Also keep in mind that the foregoing amounts may vary somewhat according to locality. There are also certain funds that employers must contribute to, such as an employee labor union fund (generally about 2% of payroll).

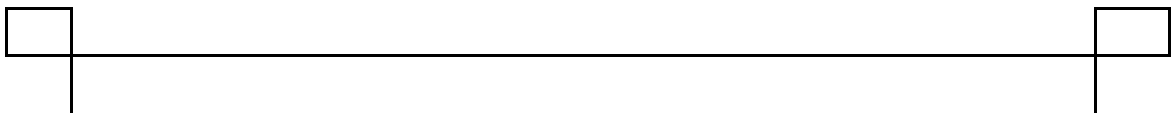
A prospective foreign investor would do well to keep abreast of breaking developments in this area, because the law is rapidly evolving.

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