THE US-CHINA BUSINESS COUNCIL
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US-China Business Council
Comments on the Draft Labor Contract Law of the People's Republic of China
(Draft of March 20, 2006)

April 19, 2006

The US-China Business Council (USCBC) appreciates the opportunity to provide comments on the draft Labor Contract Law ("Draft Law"). We believe this opportunity to comment illustrates PRC government efforts to provide more openness and transparency in the formulation of policy and legislation. USCBC represents 250 US companies that are actively engaged in doing business across all sectors in China. We are grateful for this opportunity to participate in the consultations regarding the PRC's draft labor contract law, and we hope to contribute constructively to this legislative initiative.

By respecting China's labor laws and creating safe workplaces, US companies generally bring world-class employment practices to their China operations. US companies have thus demonstrated their commitment to maintaining high standards in their China offices and facilities.

We respectfully submit that the proposed rules on labor contracts contain a number of concerns for our membership. We applaud the National People's Congress for working to create a more uniform legal structure for the protection of rights that employees and employers have. In practice, however, several provisions would result in the loss of rights rather than the gaining of rights, as the draft law intends. The Draft Law may also reduce employment opportunities for PRC workers and negatively impact the PRC's competitiveness and appeal as a destination for foreign investment.

NONCOMPETE AGREEMENTS

One goal of China's current leadership is the development of a skilled workforce in technology as well as international business practices. A by-product of workforce development is the emergence of innovative enterprises throughout the economy. In order to promote an innovative business environment, companies need assurances that laws exist, and are enforced, to sufficiently protect their intellectual property. We applaud the National People's Congress for including uniform provisions within the draft Labor Contract Law that allow all companies to use and enforce noncompete clauses in their labor contracts. Nevertheless, existing language in the current Draft Law could be improved to strengthen the rights of those who create intellectual property for the good of the economy as a whole. Areas of concern include the following:

- **Cap on damages payable to employers**: The current proposal limits compensation to an employer in the event that the employee breaches a noncompete clause. Damages to an employer whose trade secrets and intellectual property are lost to a competitor may well exceed the amount that the employee must pay, however. Removing the cap on damages that employees must pay for violating noncompete agreements would enable companies to properly value their intellectual property, thus serving as a deterrent to those who would violate these agreements. We suggest that language in the Draft Law allow parties to agree among themselves the terms of the noncompete agreement, rather than stipulate specific requirements. This would conform with Article 22 of the 1995 Labor Law.

- **Geographic restrictions**: Placing geographic restrictions on the applicability of a noncompete clause will be extremely difficult to define and enforce in practice. A company registered in one jurisdiction may sell its products in another. As information technology develops and expands, the definitions of markets and distance change, making geographic restrictions hard to specify and enforce. We recommend removing geography from the criteria to enforce a noncompete agreement.

- **Definition of terms**: Many of the terms the Draft Law uses are too broad or vague to be effective in practice. Article 16 states that an employer must pay the employee, upon departure, no less than the employee's annual salary in order to enforce a noncompete agreement. The language is unclear as to whether "salary" refers to the basic wage only or includes benefits, bonuses, etc. We suggest that language in the Draft Law allow parties to agree to the terms of the noncompete agreement, rather than stipulating requirements. This would ensure that both employees and employers understand their obligations, and that the agreement will be enforceable. Moreover, this would reflect existing practice as laid out in Article 22 of the 1995 PRC Labor Law.

- **Employee responsibility**: As written, the Draft Law lacks clauses on employees' confidentiality obligations. In order to strengthen IP protection we suggest the Draft Law include detailed articles outlining the confidentiality responsibilities of employees.

PROBATIONARY PERIODS

Through Article 21 of the 1995 Labor Law, PRC lawmakers recognized the importance of having a probationary period of suitable length for both employee and employer to evaluate fully the suitability of the work relationship. Additional provisions in the Draft Law will adversely change that relationship. Areas of concern include the following:

- **Definition of terms**: Terminology in the Draft Law regarding which types of employees may qualify for which types of probationary periods are undefined. The terms "non-technical," "technical," and "senior technical professional" are vague. This will make compliance with the rules difficult. Moreover, the lack of clear definitions will make the provision highly difficult to enforce, leading to an undue burden on authorities. We encourage the removal of these terms from the Draft Law.

- **Length of time**: The Draft Law shortens the probationary period. Consequently, it will be more difficult for employees and employers to properly evaluate the work relationship, possibly resulting in an increased number of workplace grievances. We respectfully suggest that the Draft Law adopt the provisions of the 1995 PRC Labor Law allowing employers to determine the length of a probationary period based upon the requirements of the position but not exceeding six months.

TRAINING

Companies around the world highly value the ability to train employees to succeed in their company. Training programs differ from company to company and include a wide array of formal and informal experiences of varying durations. Such training improves the overall quality of the workforce and contributes to economic growth and social stability. Under current PRC law, employees and employers sign separate contracts on their rights and responsibilities when training takes place. These separate training contracts enable both the employee and employer to evaluate their specific circumstances and design a training contract that benefits both parties. Changes under the Draft Law would negatively impact this relationship, perhaps resulting in fewer training and growth opportunities for the employee. Areas of concern include the following:

- **Limited definition of training**: The Draft Law appears to define employee training as specific technical training that occurs full-time. Such a definition does not take into account the present

reality that training occurs in multiple formats of varying time lengths. Duration is not necessarily the most important factor of the training. Moreover, certain part-time or on-the-job training may also be valuable. Attempting to define "training" will make the provision difficult to enforce, lead to confusion between employees and employers, and place an undue burden on authorities. We respectfully request that definitions of the term "training" be removed from the Draft Law.

- **Repayment for duration and type of training**: Training encompasses a wide array of opportunities, some of which are quite expensive. In the event that an employee terminates the working relationship after receiving employer-provided training, Article 15 of the Draft Law appears to limit employee repayment to employers for employer-provided training to full-time, off-the-job technical training of six months or more. From the wording, it appears that compensation for training will only cover the expenses paid to the professional training company. If an overseas affiliate were to provide the training on certain specific technology (that in most cases is of high value), it would be difficult to calculate the training expenses.

  Moreover, the employer may well have provided more than six months of training, but not on a full-time basis. In other cases, the training might be much shorter but with more significant expenses, such as overseas training. In all cases it is very difficult to calculate the true amount of training expenses and the added value that such training can bring to the employees. According to the Draft Law, the employer would not be entitled to claim compensation from the departing employee for any of the above training experiences.

  We recommend that provisions in the Draft Law discussing employee repayment for employer-provided training be rewritten to reflect current practice, which allows employees and employers to sign separate training contracts that reflect local conditions, including mutually defined terms of repayment in the event the employee terminates the labor contract.

TRADE UNION ROLE

Trade unions have always played an important role in securing the rights of workers. We are pleased to see that the Draft Law recognizes the important role that trade unions play in the relationship between employers and employees. Nevertheless, the Draft Law's provisions requiring trade union involvement in certain areas could have the unintended consequence of harming employees' interests. Areas of concern include the following:

- **Definition of terms**: The Draft Law frequently uses the term "trade union" or "employee representative." However, the term "employee representative" is not defined. We encourage the drafters to define more clearly those positions within the company structure that may serve as employee representatives.

- **Review of company policies**: Many employers provide in writing detailed handbooks, manuals, and policies to direct and support their employees' efforts. The Draft Law appropriately acknowledges that companies have a responsibility to establish rules and regulations governing work operations. Article 5, Clause 2 and Article 51, Clause 1 appear to remove from the employer decision-making authority over policies and practices for which the employer is ultimately legally responsible and liable. This raises several concerns.

  First, it is not feasible to state that an employer's regulations and policies shall be void if they are not adopted through negotiation with the trade union. In practice, employers must regularly amend or update their handbooks, guidelines, and manuals to comply with policy changes at the local and national level. Requiring the consent of the trade union before such changes can be made is overly burdensome and may prevent important company policies from being implemented in a timely manner.

Second, employers bear final and legal responsibility for environmental, health, and safety questions. As written, the draft law could limit the employer's ability to fulfill its legal responsibilities and could result in policies that might be less beneficial to workers.

Third, corporate management must stay on top of international best practices, such as strategies to protect intellectual property rights. As such, final authority and responsibility for company policies should rest in the hands of the employer.

Finally, the Draft Law includes no incentives for the trade union to negotiate with the employer. The employer, with legal and financial responsibility for the company and its operations, is on unequal footing with the trade union and can be subject to demands that could harm the long-term health of the company's operations and thus the long-term interest of the employees.

We respectfully submit that the drafters delete Article 5, Clause 2 and Article 51, Clause 1. Moreover, we recommend that drafters adjust the wording of Article 5, Clause 3 to read: "Regulations and policies of employers, which shall not be in conflict with existing laws and regulations, shall be announced to all employees internally from time to time, and such regulations and policies shall be part of the employment contract and shall be equally effective as the employment contract terms."

- **Mass layoffs:** Sections of the Draft Law appear inconsistent with existing PRC laws. Article 33 of the Draft Law requires employers that plan to terminate more than 50 employees to negotiate the terms of the layoff with the trade union or the full staff of the enterprise. This is inconsistent with Article 27 of the 1995 Labor Law of the People's Republic of China, which states that employers must inform, but not negotiate with, the trade union of the need for mass layoffs. We encourage the drafters to adopt the language regarding mass layoffs from the 1995 Labor Law.

- **Permission to terminate labor contract**: Article 35 of the Draft Law also appears to contradict existing law, as it requires the employer to seek the permission of the trade union prior to the termination of any labor contract. Article 30 of the 1995 PRC Labor Law adequately allows for trade unions to comment on and seek redress over a termination if the trade union deems the termination to have been improper or illegal. Adopting alternative wording in the final version of the Draft Law that mirrors the existing language used in the PRC Labor Law would strengthen PRC law while protecting both the rights and responsibilities of trade unions and employers.

SEVERANCE PAYMENTS

Another draft proposal that could negatively affect workplace relations, and lead to fewer protections for employees is the requirement that employers pay severance pay to an employee whose fixed-term contract expires and the employer chooses not to renew. Many jobs are for a specified period of time. An employee may sign a fixed-term contract that stipulates the employee's rights and responsibilities during that fixed-time. A fixed-term contract is a two-sided contract based on negotiation among equal parties. The employee knows when the term expires and is responsible for subsequent employment. Requiring employers to pay severance pay at the conclusion of a fixed-term contract will encourage them to sign non-fixed term contracts or to avoid signing contracts altogether. Neither of these scenarios increases protections for employees. We encourage the drafters to remove the requirement that employers pay severance pay to an employee whose fixed-term contract expires.

LABOR DISPATCH

The Draft Law currently requires employers using a labor service company to sign only one fixed-term contract with the employee. At the end of the contract the employer must hire the employee directly. If the employer chooses not to hire the employee, the employer cannot use a labor service company to hire a different person for the same position again. This stipulation impedes the right of the employer to find the best person for the job and will reduce the flexibility of human resource allocation. Moreover the provision does not take into consideration the nature of seasonal or temporary work for which labor dispatch

entities provide a valuable service and thus will possibly result in fewer job opportunities for PRC workers. We encourage the drafters to consider removing this provision from the Draft Law.

Thank you again for the opportunity to submit our comments on the draft Labor Contract Law. We would be pleased to have the opportunity to discuss our concerns in more detail at your convenience.