

## Chinese Labor Contract Law, it is not for you, dude!

### Description

One of my corporate clients recently asked about how to terminate the employment of one of its senior officers. The client is a WFOE invested by an American company. The poor employee is one who has served the WFOE for more than ten years taking up the regional sale manager position and receiving a hefty monthly salary of more than RMB 50,000. Due to the dipping Chinese economy, the WFOE company is trying to save cost by sacking some of the employees.

Now the company wants to know the best and cost-efficient way to end the employment with the manager.

The manager began working for the WFOE back in 1998, well ahead of the enactment of Chinese Labor Contract Law in 2008. Before Chinese Labor Contract Law, the severance pay is calculated in accordance with old rules which entitle the employee dismissed to receive economic compensation equal to one month salary for each year of employment in the past till dismissal. The “one month salary” in calculating economic compensation is the actual salary paid to the employee, not subject to the “three times average local monthly salary” cap. After the enactment of the Chinese Labor Contract Law, the law has set caps on the economic compensation to be received by the leaving employees.

Article 47 of the Chinese Labour Contract Law provides that in the case of payment of economic compensation, an employer shall pay one month salary compensation to the employee for each year of employment with the employer before termination of employment; but if the monthly salary of the employee is higher than three times the average local monthly salary, the economic compensation payable to the leaving employee shall be calculated based on the amount equal to three times the average local monthly salary. For example, in Shanghai, the average local monthly salary of 2011 is RMB 4,331, and three times of it is RMB 12,993, an amount that should be regarded as at the middle level of salaries in the human resource market. In other words, under the Chinese Labor Contract Law, an employee ending employment in 2012 in Shanghai can only receive up to RMB 12,993 as compensation for each one year of employment with his employer. In addition to this restriction, the Labor Contract Law has also made it clear that the employer will only pay 12 month salary at most for the economic compensation. This has indeed reduced the burden on employers to fire their employees but has also caused wide outcries by middle class people in Shanghai, not to mention top corporate officers who may snap up millions of RMB in a year.

In our case, upon agreement on termination of labor relationship between the manager of the WFOE company, calculation of the economic compensation of the employee shall be divided in two parts: one prior to enactment of Chinese Labor Contract Law which is not subject to the three times rule, and second part after the enactment of Chinese Labor Contract Law which is subject to the three times rule. Assuming his current salary is RMB 50,000, his total economic compensation will be RMB  $50,000 \times 10 + 12,993 \times 2 = \text{RMB } 525,986$ . In the formula, 10 represents the number of years of the manager's employment with the WFOE prior to Chinese Labor Contract Law, and 2 is the difference of the maximum number of years of employee's employment with employer in calculating economic

compensation, 12, minus the 10 years already calculated in the formula.

Well, the RMB 525,986 is quite nice an amount, isn't it? But wait, this is not the most cost-efficient way of terminating the employment with the manager. We can do better by going illegal.

Though the old rules before enactment of Chinese Labor Contract Law allow the calculation of economic compensation based on the actual full monthly salary, there is no relevant rules governing the illegal termination of employment by employers. However, in the Chinese Labor Contract Law, specific rules are written therein to govern and prevent illegal termination of employment by employers. It is provided in the Law that in the case of illegal termination of employment by employers, employers shall pay the so-called "damages" equal to two times economic compensation calculated under the labor contract law to the unfairly treated employees.

As the "damages" rule is prescribed in the Chinese Labor Contract Law only, if the WFOE terminates the manager's labor contract illegally, the legal liability imposed on the WFOE is to pay the damages to the manager in accordance with the Labor Contract Law. The amount of damages is RMB  $12,993 \times 12 \times 2 = \text{RMB } 311,832$ , substantially less than the economic compensation computed above.

One may reasonably counter-argue that in the spirit of justice that should be the ultimate pursuit of any legislation, in the case of illegal termination, employer should pay the damages equal to the double of the economic compensation of RMB 525,986, which should be RMB 1,051,972. This is a very powerful argument if presented in the jurisdiction where there is real rule of law. But in China, this is not the case. At least in Shanghai, the Shanghai People's High Court, the highest local court authority, has once made it very clear that the damages paid to employees shall be calculated in the formula set out in the preceding paragraph. In other words, the WFOE can send the manager away at a cost of RMB 311,832.

On a separate note, while it is the most cost-efficient way of sacking the manager, it may not be a wise decision. High ranking officers may cause big trouble if they feel unhappy, a real risk companies should take into account when dismissing those heavyweight employees.



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