



Hong Kong and Chinese Employment Law Update

Winston & Strawn's Labor and Employment Relations Practice Group is pleased to announce the addition of employment law capabilities in Asia. We now have attorneys with broad experience and capabilities in the wide range of employment law issues that affect, and are unique to, companies employing personnel in Hong Kong and China.

Highlights Concerning Hong Kong and Chinese Employment Law

Although the Hong Kong Special Administrative Region ("Hong Kong") is part of the People's Republic of China ("PRC" or "China"), Hong Kong and China have fundamentally different legal systems with very different approaches to employment law.

The Hong Kong legal system is based on the English legal system, although with many "Hong Kong characteristics." Hong Kong's flexible employment law regime is generally considered to be one of Hong Kong's selling points when foreign companies establish subsidiaries or offices in Asia. PRC law is a continental legal system, and employment law is based on the 1995 Labor Law and a 2007 Labor Contract Law, together with other associated legislation. PRC labor legislation favors the employee and the (government-backed) trade union, and is much less flexible than its Hong Kong counterpart. Some of the provisions in the new Labor Contract Law reflect an attempt by the government to stop some of the abuses that occurred because of legislative and enforcement inadequacies.

Hong Kong employment law is generally familiar to Americans, and favors a free market approach, although it imposes certain statutory requirements on employers generally not seen in U.S. employment law. The primary source of Hong Kong employment law is the Employment Ordinance, although other Hong Kong legislation, as well as the common law, are also relevant. This briefing will highlight some of the similarities and differences between the two jurisdictions, including:

- written employment contract;
- lay-offs;
- termination of employment; and
- severance payments.

1. Written Employment Contract

Hong Kong and PRC positions are superficially similar regarding written contract requirements.

In general, an employment agreement in Hong Kong can be oral or in writing. However, for employment intended to be for a period of longer than one month, a written employment contract should be signed by both the employer and the employee. In the absence of such formalities, the employment contract will be regarded as a contract of one-month duration, which is renewable

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from month to month. Employers may use a formal contract or offer letter countersigned by the employee, and the terms may be supplemented by an employee handbook, or other written or oral terms. However, unlike the PRC, there are no penalties on the employer for failure to provide a written contract, and there are few matters that must be set forth in the contract. There are employee protections that are compulsory and may not be avoided by contract.

In the PRC, prior to the promulgation of the Labor Contract Law, written contracts were also required, but generally no penalties were imposed for the violation of this requirement. The Labor Contract Law now imposes significant penalties on employers for failure to comply. Manufacturing facilities in southern China often did not have written contracts with their staff, frequently with the complicity of staff. Management favored what they saw as a way around rigid legal requirements in terminating staff, as well as a way of minimizing social insurance and other government payments. Employees saw it as a way to maximize their take-home pay and avoid substantial social insurance payments under a system that is currently not portable nationwide. Under the Labor Contract Law, written contracts must be concluded within one month of the employment date, and the law requires the inclusion of certain provisions. If the employer fails to do so, he must pay the employee double his salary or wages, and if a written contract is not concluded within one year, the fixed-term contract under which it is presumed the employee was meant to be hired will be automatically converted to an open-ended contract. An open-ended contract is one that will not automatically expire at the end of a term, and makes termination difficult.

2. Lay-Offs

With the worldwide economic downturn, many employers in Hong Kong and mainland China are seeking to reduce their workforce.

In China, significant obstacles are placed in the way of companies seeking to do so, which is why many companies simply shut down their factories or offices and foreign managers leave the jurisdiction.

The Labor Contract Law requires that the company be virtually at the edge of bankruptcy before it can lay-off staff for economic reasons. Additionally, before an employer can retrench 20 or more employees (or 10 percent, if fewer than 20 are being retrenched, but that number is at least 10 percent of staff), the employer must explain the situation to the labor union or staff 30 days in advance and report to the labor authorities. This rule is being reiterated in local regulations

issued in response to the economic downturn. Staff that are terminated in a lay-off must receive severance payments in addition to full payment of wages, and the employer must make full social insurance payments for them. During an economic downturn, small companies often close down and leave staff that have not been paid in full and desperate workers often turn to the local government to fill the gap.

In Hong Kong, there is no similar restriction regarding lay-offs. Dismissal by reason of redundancy or lay-off is permissible (without government approval). Nevertheless, employees with at least two years of continuous service (as defined by statute) are entitled to severance and an employee with five years of service is entitled to a long service payment. The Employment Ordinance imposes penalties for non-compliance with such payment obligations. The Employment Ordinance specifies minimum severance and long service payments, both of which are described in the next section. An employer may choose to provide more generous terms by contract, company policies, or past practices. If the company is liquidating, the employees are treated as preferred creditors, and they will be entitled to receive their payments before unsecured creditors.

3. Severance Payments

Payment of severance is an area in which the employer's burden has increased under China's new Labor Contract Law, and where the mainland and Hong Kong have similar provisions.

Chinese law requires one month's salary for every year of service (for a maximum of 12 years), although the Labor Contract Law imposes a cap on the salary considered for such purposes (as in Hong Kong). The Labor Contract Law also now requires severance payment when a fixed term contract expires and will not be renewed by the employer, to encourage employers to hire staff for longer periods. Prior to the Labor Contract Law, because of the difficulty in terminating employees, many employers had hired staff on one or two year fixed term contracts, and if staff did not meet expectations, they were simply not re-hired at the end of the contracts, and severance did not need to be given. Similarly, if staff were hired for the term of a project and were not re-hired at the end of the project, previously they were not owed severance pay. The Labor Contract Law requires severance in both situations.

In Hong Kong, employees (who have been employed under a continuous contract for not less than 24 months) and who have been laid off, or whose positions have been made redundant, are entitled to severance. With certain exceptions,

an employee is deemed to have been dismissed by his employer and entitled to severance payment if the contract under which the employee is employed is terminated by the employer with or without notice or payment in lieu, or where an employee's fixed term contract expires and is not renewed. The Employment Ordinance also specifies the minimum amount and the procedure for making severance payments. Similar to the mainland, the Employment Ordinance imposes a cap on the amount of statutorily required severance, although the parties are free to provide for more.

4. Termination of Employment

Termination of employees is easier in Hong Kong than in China. In Hong Kong, an employment contract can be terminated in a number of ways, such as performance, by mutual agreement, by notice, or by payment in lieu of notice. Subject to any requirement stipulated in the employment contract and statutory requirements such as written notice, severance payment, or long service payment, employers and employees are free to terminate their employment contract. Under usual circumstances, a written notice is required and the statutory minimum of notice period is seven days. Alternatively, it is possible to terminate an employment contract early by paying out a sum in lieu of the notice period. However termination of contract without notice or payment in lieu is also permissible in cases such as fraud or dishonesty on the part of the employee.

In China, termination by mutual agreement also is possible, but unilateral termination by an employer is difficult, unless the employee has committed a serious violation or is obviously unsuited for the job. Termination without notice is possible for major violations such as a material breach of the employer's rules or regulations or serious dereliction of duty. However, to terminate an employee with one month's notice (or one month's salary in lieu of notice), an employer must provide evidence, such as the worker is "incompetent and remains so after training or adjustment of his position," or that "a major change of the objective circumstances relied upon during the conclusion of the contract render the contract unperformable."

Conclusion

The Chinese authorities are clearly concerned about a dramatic increase in unemployment resulting from the

financial crisis. Upcoming legislation will either reiterate the obligations in existing law or seek to restrict lay-offs further. The likelihood, however, is that in this economic climate, desperate employers may continue to simply walk away from their employment obligations.

The Hong Kong government also is concerned about unemployment during the financial crisis, but, at this time, is looking to various forms of job creation, such as the initiation of major infrastructure projects next year, temporary civil service jobs, and increased loans to small and medium enterprises, rather than changes to its legislation.

If you have any questions regarding this Briefing, please contact one of the Labor and Employment Relations Practice Group partners listed below.

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