

China's Remedy For Labor Inequity Could Spark Unrest

Law360, New York (April 02, 2013, 11:05 AM ET) -- The Standing Committee of the National People's Congress of the People's Republic of China recently passed amendments to the PRC Employment Contract Law (ECL), which will take effect on July 1, 2013. If strictly enforced, they will severely limit the ability of employers in China to use dispatched workers from labor dispatch agencies.

Background

In China, "dispatched workers" are employed by authorized labor dispatch agencies. Labor dispatch agencies send dispatched workers to work for companies in accordance with terms of service agreements that they sign with the companies. There is no employment relationship between the companies and the dispatched workers. This system was created in the late 1970s when foreign companies were allowed back into China, and its use by both Chinese and foreign companies has become widespread. Companies use dispatched workers primarily to reduce labor costs, as dispatched workers are generally paid less or given fewer benefits than employees, or to get around headcount restrictions.

The four main dispatch agencies are the Foreign Enterprise Service Corporation (FESCO), which is the largest, China International Intellectual Corporation (CIIC), China Star Corporation for International Economic and Technical Cooperation (China Star), and China International Enterprise Co-operative Corporation (China International).

The ECL, which came into effect in 2008, attempted to limit the use of dispatched workers. The ECL currently states that employers should generally use dispatched workers for temporary, auxiliary or substitute positions. This implies that dispatched workers can also be used for positions that do not fall within the three categories in some cases. Additionally, there are currently no definitions as to what constitute temporary, auxiliary or substitute positions. As a result, employers have been able to use dispatched workers for extended periods of time and for a significant portion of their workforce, which clearly violates the intended restrictions on the use of dispatched workers for temporary or auxiliary positions.

The continued use of dispatched workers in this manner goes against the original intent of the ECL, which was to encourage direct employment relationships between workers and employers to provide greater legal protection for workers. It also contravenes the equal pay for equal work requirement set out in the Labor Law, which became effective in 1995. Another issue for dispatched workers is that if the employer has a labor union, they cannot join it as they are not employees.

The new amendments are meant to rectify the current situation and enforce the original intent of the ECL, as well as the equal pay for equal work concept. They will have significant consequences for employers and have the potential to spark social unrest. The All-China Federation of Trade Union, China's only authorized labor union, estimates there are 60 million dispatched workers in China. Employers are not going to take on all of these workers as direct employees, so if the rule is strictly enforced when it comes into effect in July instead of being gradually implemented, that would likely

result in massive layoffs in the second half of 2013. This could create a far worse situation than the current use of dispatched workers by employers in China.

New Limits on Use of Dispatched Workers

The amended ECL provides that the use of dispatched workers can only be used for temporary, auxiliary and substitute positions. The term only will replace the term generally that currently appears in this provision. These types of positions will now be defined as follows:

- A “temporary” position is one that will last for no more than six months.
- An “auxiliary” position is one that provides a supporting role to an employer’s core business.
- A “substitute” position is one where workers are hired to temporarily replace employees who take time off to study or go on leave.

Employers will also be limited in the proportion of dispatched workers that can comprise their total workforce. The Ministry of Human Resources and Social Security will specify this limit at a later date. Some provinces have already issued their own draft regulations on this issue. Guangdong province, for example, indicated in early 2012 that it would set this limit at 30 percent. Jiangsu province issued draft regulations, which set the limit at 50 percent, but this was removed from the version that was implemented, which simply states that it shall be “in compliance with limits provided by law.”

Equal Pay for Equal Work

The amended ECL provides that dispatched workers must be paid the same as directly hired employees in the same position. This reinforces the equal pay for equal work principle set out in the Labor Law.

Penalties

The amended ECL provides that an employer can be fined up to 10,000 Chinese Yuan (approximately \$1,600 USD) per dispatched worker if it violates the new rules.

New Requirements for Labor Dispatch Agencies

The amended ECL provides that labor dispatch agencies are required to meet a higher capital requirement of 2,000,000 Chinese Yuan (approximately \$322,000 USD) and obtain a special license from the local labor authority. The capital requirement is currently 500,000 Chinese Yuan (approximately \$80,000 USD).

Representative Offices?

The amendments do not address representative offices, which are China based offices that are directly connected to a foreign company. Representative offices do not have legal person status. Technically, the ECL does not apply as representative offices are not qualified to be employers under PRC law. They are currently required to retain the services of PRC nationals through a labor dispatch agency because they cannot enter into employment relationships with individuals that work for them. It is therefore assumed that the amendments will not apply to representative offices.

Implications for Employers

Continue with Dispatched Workers?

Employers that use dispatched workers will need to determine if they will be able to continue to use such workers once the amendments become effective. If they cannot, employers need to determine what they will do with dispatched workers going forward. If some of the dispatched workers need to be returned to the dispatch agency, this will likely need to be handled as an employee termination. Under the terms of most labor dispatch service agreements, a company needs to have cause to unilaterally return a dispatched worker to a dispatch agency. Specific grounds for termination set out in the service agreement will mirror what is required under the ECL.

The amendments relating to dispatched workers will likely not be sufficient cause for termination. In such cases, the most likely option will be direct negotiations with the dispatched worker. This can be expensive, as companies will likely need to provide a financial settlement to all returned dispatched workers. The current market practice is to pay between two to four months' additional full salary, but the exact amount in each case will depend on an employer's specific situation.

Another alternative is to persuade dispatched workers to resign, in which case no statutory severance or financial incentive needs to be paid. However, it is unrealistic to expect that dispatched workers would agree to this.

Review Service Agreements with Labor Dispatch Agencies

If employers continue to use dispatched workers, they will need to review the terms of their service agreements with labor dispatch agencies to determine if anything needs to be renegotiated in light of the new rules. In particular, they will likely need to renegotiate the dispatch term. The ECL requires labor dispatch agencies to sign employment contracts with dispatched workers that have a term of at least two years. As a result, the agencies will require companies to use dispatched workers for a period corresponding to the term of their employment contracts. The new regulation now limits companies use of temporary workers to six months, but the requirement for dispatch agencies has not been changed.

Verify Dispatch Agency Compliance

Employers will need to ensure that the labor dispatch agencies they use comply with the new rules. Otherwise, the employer could be subject to penalties for the noncompliant status of an agency.

Representative Offices

Representative offices should closely monitor further developments after the amendments take effect to ensure there are no changes to the requirement that they retain the services of PRC nationals through a labor dispatch agency.

Conclusion

Companies using dispatched workers must start planning to either take them on as full employees or lay them off. This does not necessarily mean that dispatched workers need to be hired or laid off in July when the amendments take effect. Instead, companies should monitor further developments, particularly the views of the local labor authority and the proposed manner in which they plan to enforce the restriction.

It is likely that the authorities will take a soft approach to enforcement, with a gradual approach to implementing the new restrictions. The Ministry of Labor and Social Security had been trying to restrict the use of dispatched workers long before the amendments were introduced, but other government agencies have a strong interest in keeping the status quo. The state-owned Assets Supervision and Administration Commission controls China's largest state-owned companies, many of which rely on temporary workers for a majority of their workforces. Additionally, the labor dispatch agencies are government owned, and the new restrictions will mean a significant loss of revenue for them. Finally, even if only a small percentage of the 60 million dispatched workers are laid off, this has the potential to cause widespread labor unrest. Given the government's focus on maintaining social harmony, they will want to avoid such situation at all costs.

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