Managing Layoffs in the People’s Republic of China

Until very recently layoffs in multinational companies in the People’s Republic of China (PRC) have been very rare. When the PRC Employment Contracts Law (ECL) was promulgated in July 2007, few employers focused on Article 41, the provision regarding mass layoffs. The Chinese economy was performing well and there was no reason for companies to consider that layoffs would be required. When the ECL took effect on January 1, 2008, companies were still expanding and focusing on recruiting and retention issues.

The tides have since turned and both domestic and multinational companies (MNCs) in the PRC are feeling the effects of the global economic crisis and engaging in or considering workforce reductions, among other labor cost cutting measures. Managing the issue of whether and how to conduct layoffs in the PRC is challenging and requires advanced preparation.

Limited Grounds for Terminations in the PRC

As a threshold matter, it is important for employers to understand that employers may only terminate an employment contract for a reason that is specifically enumerated in the law. Deciding to make an employee’s position redundant in order to reduce overhead and labor costs does not in and of itself constitute a valid basis to terminate staff.

As an initial step in deciding whether to conduct a mass layoff as defined by the ECL, the employer will need to assess the number of staff it intends to make redundant and whether that number will trigger the mass layoff procedures. Article 41 of the ECL defines a mass layoff as the dismissal of at least 20 employees or 10% or more of the “total number” of the employer’s workforce.

Timing the Process Effectively

Advance planning is essential if an employer believes that it will reach the threshold of a mass layoff. The ECL creates an increased administrative burden with respect to conducting a mass layoff, which reflects the law’s goal of encouraging longer term employment relationships and discouraging dismissals. Employers should understand that they cannot terminate employees as soon as the decision to conduct the layoff is made. Rather, the employer should plan that the process will take at least 40-60 days and work backwards to plan for a smooth transition period. This 40-60 day timeframe is based on the employee consultation procedure built into Articles 43 and 41 of the ECL and the requirement that employers submit a workforce reduction plan to the local labor authorities in advance of any mass layoff.

Basis for Termination

The employer must also consider whether the basis for the planned terminations falls within the categories set out in Article 41. Staff reductions may only be supported by one of the grounds set forth in either the PRC Labor Law or the ECL.
• restructuring pursuant to the Enterprise Bankruptcy Law;\textsuperscript{4}
• serious operational or production difficulties, which are generally interpreted as economic in nature;\textsuperscript{5}
• a change in production method or automation of a business process through technical innovation, and a suitable alternative cannot be agreed upon with the employee despite consultation; or
• a major change in the objective circumstances of the employer which were relied upon at the time of the conclusion of the employment contracts, rendering them unable to be performed (for example, where there is a departmental reorganization and the employee's original job no longer exists).\textsuperscript{5}

If the employer's situation does fall under one of these categories, then it must consider its list of employees and whether any of those employees are subject to protection from termination.\textsuperscript{7} Contrary to the way in which many MNCs carry out the selection process, the ECL prescribes specific provisions for the retention of employees without regard for employee performance or job function. In other words, the ECL provides specific preferences with respect to who may not be made redundant, without regard to job function. The "protected" categories of employees are those employees: (a) with comparatively longer term fixed-term employment contracts, (b) with open-ended employment contracts, and (c) who are the sole wage earners in the household and support an elderly person or a minor.\textsuperscript{8} Accordingly, deciding who is eligible for a workforce reduction requires careful investigation and inquiry in order to ascertain who fits into these categories.

Employers should further be wary of potential discriminatory grounds on which they select employees for termination, although enforcement of the anti-discrimination laws has been historically weak. PRC law protects employees from discrimination on the following grounds: infectious disease carriers (\textit{i.e.,} Hepatitis B carriers), disability, ethnicity, gender, marital status, pregnancy, race, religion, and rural workers.\textsuperscript{9}

Moreover, Article 42 of the ECL contains additional categories of employees who are protected from dismissal:
• employees who have been exposed to occupational disease hazards and have not undergone a pre-departure occupational health check-up, or are suspected of having contracted an occupational disease and are being diagnosed or under medical observation;
• employees who suffer from occupational disease or who have been confirmed as being totally or partially unable to work;
• employees suffering from an illness or non-work-related injury and the medical treatment period has not expired (depending on an employee's service years with the employer and service years in the workforce, the medical treatment period may last from 3 to 24 months);
• employees who are pregnant, on maternity, or in the nursing period (which is one year measured from the baby's birth date);
• employees who have been working continuously for the employer for at least 15 years and are less than 5 years away from the legal retirement age.\textsuperscript{10}

Once the employer determines that its workforce reduction will fall squarely under Article 41, it must then engage in the initial consultation process with the labor union (to the extent that one exists in the company) or all of the employees. The employer must provide the employees with at least 30 days' written notice of the workforce reduction and explain the circumstances behind the proposed redundancies. The employer must then consider the opinions of the labor union or the employees. If handled correctly, proactive engagement with the company's labor union should facilitate the process, as should open communication with the employees who are targeted for the layoff. The employer should also communicate with those employees who are not selected for the
layoff to allay rumors, fears and commitment concerns among those employees.

**Communicating the Layoff Plan**

Employers should carefully consider the nature of their workforce and how they propose to communicate news of the layoff plan to employees. Depending on the number of staff involved, conducting meetings with smaller groups of employees may, for example, create less opportunity for large numbers of disgruntled crowds of employees to gather. Employers should also think about the safety and welfare of those individuals who will physically deliver the message to the employees.

If the employer chooses to go forward with the mass layoff, it must then submit a workforce reduction plan (Plan) to the labor authorities. The Plan should include, at a minimum:

- the applicable information to demonstrate the legal basis for the mass layoff;
- the number of employees affected; the schedule for the layoffs;
- details of the severance payments; and
- consideration of the union or employees’ input.

Although the ECL is ambiguous with respect to whether approval of the Plan from the labor authorities is required, in practice, an employer will find it difficult to proceed without receiving that approval.

**Alternatives to a Mass Layoff**

In cases where the employer’s planned terminations do not meet the ECL’s definition of a mass layoff, or the employer does not want to proceed with a mass layoff, but still wants to reduce headcount, there are a number of additional issues for the employer to consider.

Employers should consider whether immediate layoffs make economic sense, in light of the high costs of separation packages and future recruitment and retraining costs. As unemployment rates continue to rise and present a challenge for China this year, the PRC government is actively encouraging employers to consider and implement other remedial measures that fall short of redundancies, such as reduced hours, shortened work weeks, wage reductions, and furloughs or forced shutdowns.

Employers may also weigh approaching individual employees to obtain their consent to terminate their employment relationships by mutual agreement, as provided by Article 36 of the ECL. Using this approach, employers must consult with individual employees, which may be more time-consuming, but which also may result in the execution of signed settlement agreements and releases and does not require government reporting. Employers should anticipate meeting some resistance from the employees and accommodating the need for employees in the PRC to negotiate their separation packages.

If the entity seeking to conduct a layoff is a representative office, the employer must take into account additional considerations. Representative offices must hire PRC nationals through a staffing agency, which adds an extra layer of complication because the representative office may not unilaterally terminate an employee whom it identifies as redundant and is seconded through a staffing agency. Rather, the representative office must reach an agreement with any affected individual, unless the representative office is closing, which provides an independent legal basis for the dismissal. These same concerns also apply for companies that hire any staff through a staffing agency.

Accordingly, employers with staff hired through staffing agencies must account for this added intricacy and may use the staffing agencies strategically to assist them in convincing recalcitrant employees to agree to their termination in exchange for a generous separation package. In our experience, however, this strategy will not work if the employer is neither candid with the staffing agency nor offering the minimum severance requirements set by law.

**Ensuring Compliance with Severance Calculations**

Staff who are laid off are entitled to statutory severance. The ECL has increased the
complexity in calculating severance compensation. Generally, an employee should receive severance based on the number of consecutive years worked with the employer at the rate of one month's average monthly wage for each year of service. The employee's "average monthly wage" is based on the employee's total income for the twelve months immediately preceding the employee's termination, including all cash payments such as commissions, allowances, bonuses, subsidies, etc. In addition, employers must round up any partial period of employment of six months or more to one year, thereby entitling the employee to a month of wages. Any period of less than six months entitles the employee to one-half of his/her monthly wage.

The ECL further imposes a cap on the amount of required severance. The ECL limits the severance amount to (a) three times the average "monthly wage" of employees for the previous year in the city where the employer is located, and (b) for no more than 12 years of work. These caps have had the effect of assisting employers negotiate packages with highly paid employees because the caps tend to be far lower than the employees' average monthly wages.

Nonetheless, the caps on severance do not apply to severance entitlements which accrued prior to the ECL's effective date of January 1, 2008. The calculation of severance for service that accrued prior to January 1, 2008 depends on the applicable local regulations, which vary widely from municipality to municipality and province to province.

Calculating severance accurately is critical. If an employer fails to pay the full severance amount to a dismissed employee, it could face penalties of 50% of the overdue amount. In reaching agreements with employees on separation packages, employers should also pay attention to annual leave entitlements and the issue of required encashments and company policy.

Conclusion

In sum, employers in the PRC must tread carefully in the realm of mass layoffs. Due consideration of alternative measures short of layoffs should be considered, particularly in light of the increased administrative burden under Article 41 of the ECL and the PRC government's discouragement of laying off staff before employers consider or implement alternative arrangements. Nonetheless, the option of reaching mutual agreements with employees remains a steadfast approach, although it generally requires employers to offer significantly larger packages than those required by statute.

10 The legal retirement age for male and female blue collar workers is 55 and 50, respectively, and for male and female white collar workers is 60 and 55, respectively.


12 See, e.g., Circular Regarding the Report of Mass Layoffs by Employers, issued by the Shanghai Bureau of Human Resources and Social Security, Jan. 8, 2009 at reply for receipt of report (encouraging employers to use such remedial measures in “Solemn Statement” in order to avoid layoffs).

13 See ECL, art. 46(4); see Circular of MLSS on Printing and Distributing the Provisions on Personnel Reduction Due to Economic Reasons in Enterprises, effective Jan. 1, 1995, art. 4.

14 See Implementing Regulations to Employment Contracts Law, effective Sept. 18, 2008, art. 27.

15 See ECL, art. 47.

16 At present, for example, the cap in Beijing is RMB11,178/month and in Shanghai, RMB9,876/month.

17 See id. art. 85.