Reforming the Labor Dispatch Model

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On July 1, 2013, an amendment (the “Amendment”) to the PRC Employment Contract Law aimed at further regulating the staffing business (the so-called “labor dispatch” model in the PRC) will take effect.

Under the labor dispatch model, a staffing agency hires and is the legal employer of a person (a dispatch employee or an agency worker) but leases that person to another entity (the user entity) to perform services. Because of the constant pressure to maintain a flexible workforce and control and reduce costs, and the difficulty of terminating employees in China, almost every company uses or has used dispatch employees. According to reports, the number of dispatch employees currently working in the PRC exceeds 60 million, the majority of whom are employed by government or semi-government agencies or state-owned companies. The largest staffing agencies, like FESCO and CIIC, are owned by the government.

Employers with or considering operations in the PRC should be aware of the following changes when the Amendment goes into effect this summer:

• **New Restrictions on Staffing Agencies.** The Amendment will raise the minimum registered capital for a staffing agency from RMB 500,000 to RMB 2,000,000 (regular companies need only have minimum registered capital of RMB 30,000). The Amendment also introduces a requirement that staffing agencies obtain a special permit from local labor authorities to engage in the labor dispatch business. On April 19, 2013, the Ministry of Human Resources and Social Security (MHRSS) released draft regulations on permits for staffing agencies for public comments. The draft regulations aim to set forth the procedural requirements and rules for application, approval and renewal of the permits, and punishment for noncompliance. Existing staffing agencies are not grandfathered and are required to obtain the special permit within one year after the Amendment takes effect in order to continue the dispatch business. The permit is only valid for three years, and staffing agencies are required to apply for a renewal upon expiration. Staffing agencies also are required to report their operating conditions to the local authorities on an annual basis. Finally, the draft regulations provide that foreign investors are prohibited from establishing wholly-owned staffing agencies in the PRC and may only establish joint ventures with the PRC staffing agencies.

Employers currently utilizing dispatched labor should consider their relationships with staffing agencies, especially foreign-invested ones, and develop contingency plans (such as
plans to transfer employees to other staffing agencies, if possible) in the event that their current agencies are unable to obtain the necessary permit on or before June 30, 2014. This is more likely to be a concern for small and midsize staffing agencies. Employers also should plan for potentially increased costs if smaller firms are driven from the market as a result of these changes, leaving only the large, usually state-owned, staffing agencies to fill the void.

- **Restrictions on Positions for Dispatch Employees.** Although the ECL currently provides that dispatch employees "generally" should be used in temporary, auxiliary and substitute positions, these categories are not defined and use of dispatch employees is not strictly limited to such situations. As a result, this provision generally is ignored in practice, and dispatch employees are used in almost every type of position. The Amendment expressly limits the use of dispatch employees to the listed categories and provides, for the first time, definitions for these categories:
  - **Temporary** positions are those that exist for less than six months;
  - **Auxiliary** positions are non-core business positions that provide support to the company’s core business. The Amendment fails to give any further details of what positions fall in the scope of “auxiliary”. While it is commonly understood that positions like reception, administrative work, internal IT services, and the like would be considered auxiliary, it is unclear whether other positions like finance, legal, and sourcing also could be considered auxiliary because such positions support the core business of a company; and
  - **Substitute** positions are those filled by dispatch employees because the regular employee in the position is absent from work because of off-the-job education, leave of absence, etc.

These categories (particularly the category of auxiliary positions) remain vague, so it is not clear whether or how stringently the new restrictions will be enforced.

- **Restrictions on the Number of Dispatch Employees.** The Amendment also requires a user entity to restrict the use of dispatch employees, and the number of the dispatch employees may not exceed a certain percentage of its total workforce. MOHRSS has not yet promulgated the exact limit, but educated observers have indicated that the limit is likely to be between 5% and 20% of the workforce. User entities would be given a transition period to reduce gradually the number of dispatch workers in order ultimately to comply with the required percentage. Because of these restrictions, along with the restrictions on the positions that can be filled by dispatch employees, user entities should have a plan to restructure their current workforce if it consists of a large portion of dispatch workers. For example, companies may consider converting dispatch employees to regular employees or outsourcing the current work done by dispatch workers. Note that employment contracts with dispatch employees and dispatch agreements that duly were executed on or before December 28, 2012, the date that the Amendment was promulgated, are allowed to continue until they expire. As a result, depending on the actual circumstances, the restructuring plan does not necessarily need to be completed by July 1, 2013.

- **Equal Pay for Equal Work.** The Amendment reiterates the existing requirement that a dispatch worker is entitled to equal pay for equal work (as compared to regular employees of the user entity). This reiteration is aimed at addressing the reality that many companies provide lower pay and/or benefits to dispatch employees. Although the requirements are quite vague (not addressing, for example, how equal work should be defined and/or whether benefits are considered part of "pay"), employers should seek to comply by reviewing their employment rules and eliminating any that
would constitute a violation on their face (e.g., a policy that expressly provides for fewer days of annual leave for dispatch employees than for regular employees).

- **Enhanced Penalties for NonCompliance.** The Amendment provides that the labor authorities may impose a fine between RMB 5,000 and RMB 10,000 per person on a staffing agency or a user entity that violates the Amendment and refuses to rectify the violation after being ordered to do so by the labor authorities. The Amendment is silent as to whether a dispatch employee can convert himself to a regular employee if wrongfully hired as a dispatch employee and/or could resign and claim constructive dismissal.

Despite the vagueness of certain aspects of the Amendment, companies would be prudent to undertake efforts aimed at compliance. Although it is not clear how stringent enforcement will be, experience in the PRC suggests that an uptick in enforcement is possible in a short period after the Amendment comes into effect on July 1, 2013, as the government seeks ways to propagandize and promote the Amendment. Thinking about these issues proactively may prevent a scramble to make (potentially disruptive) changes later in response to a government inquiry.

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