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Impact of New PRC Labor Contract Law on Employers

After extensive debate, the PRC Labor Contract Law was enacted on June 29, 2007 and will take effect on January 1, 2008. Compared to the existing Labor Law, the new law sets out in more detail the arrangements that are to be made between employers and employees.

One key element of the new Labor Contract Law is the requirement on employers to enter into written contracts with their employees and the push towards implementation of open-ended contracts rather than fixed term contracts. Under the new law, if an employer fails to enter into a written contract with an employee within one month after commencement of employment, the employer is required to pay to the employee twice the employee's salary for up to one year. In addition, the new law requires fixed term contracts to be converted into open-ended contracts upon the third consecutive renewal of the employment contract unless otherwise requested by the employee. One other important issue to note is that the new law requires employers to pay severance to employees upon expiry of fixed term contracts unless an employee has elected not to renew a fixed term contract on the same or better terms.

Severance payment is calculated based on the number of years of service and the general rule is that one month's salary should be paid for each year of service. The practical effect of these provisions is that the commonly used one-year contracts are no longer cost-efficient alternatives for employers since employers will be required to either renew the contracts on the same terms or pay severance to the employees upon expiry of the one-year contract.

The new PRC Labor Contract Law also contains detailed provisions on a range of other issues, including the enforceability and implementation of confidentiality and non-compete provisions. The maximum period that can be imposed for non-compete obligations is two years and can only be imposed upon senior managers or senior personnel who hold confidential information. It should be noted that employers will be required to make payments to the employee on a monthly basis during the non-compete period, although it appears that the payment can be negotiated between the parties.

In light of the changes introduced by the new Labor Contract Law, employers in the PRC would be well advised to take active steps now to review their existing employment contracts and employment policies to ensure compliance with the new law.



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