

# Checklist for Reducing Staff in China due to Restructuring



In general, an employer in the mainland of People's Republic of China ("China", excluding Hong Kong, Macao and Taiwan solely for the purpose of this article) can only unilaterally dismiss his employees in writing and for at least one of the statutory reasons.

In the course of a restructuring, to reduce their staff, among others employers often consider using dismissal due to material change in the underlying objective circumstances, mass layoff, mutual termination or ending by law due to earlier dissolution of the employer.

**Below is a summary of certain relevant issues based on our practical experiences:**

### **Dismissal due to Material Change in the Underlying Objective Circumstances**

In China, if the underlying objective circumstances are undergoing a material change, the employer might be entitled to dismiss the employee concerned unilaterally.

The "objective circumstances" mentioned above refer to force majeure events or other events (such as company's relocation, mergers, splitting, sales of company's assets etc.) that make the labor contract fully or partly not performable even after contract modification attempt.

The Chinese courts usually scrutinize and construe this dismissal ground very carefully and narrowly. In practice, the courts had also supported dismissals due to cancellation of an entire department caused by the poor economic situation and after a failed contract modification attempt. In contrast, mere cancellation of a single position would be difficult to be determined by the court as a lawful dismissal ground.

**In the case of dismissal for material change in the underlying objective circumstances, the employer should comply with the following steps:**

- 1** Upon occurrence of the relevant material change in the underlying objective circumstances, the employer should not only well document the change itself and its consequences, but also the employer's intentions and attempts to reach an agreement on corresponding amendment(s) to the current labor contract with the respective employee;
- 2** If no consensus could be reached, the employer should notify the company's trade union (if any) or the local district trade union of the dismissal reason;
- 3** Then the employer may dismiss the employee by giving the employee 30-day prior written notice or one month's salary in lieu of notice;
- 4** The statutory severance (please refer to below Statutory Severance) and other entitlements of the employee must be paid to the employee and a termination certificate must be issued to the employee on the termination date;
- 5** Within 15 days after the termination date, the employee's social insurance, housing funds relationships and personal files shall be transferred and the employee's employment shall be deregistered with the competent authority.

## Mass Layoff

If any of the following circumstances makes it necessary for a company to reduce the workforce by 20 persons or more, or less than 20 persons but accounting for 10% or more of the total number of employees of the employer ("mass layoff"), the employer may only do so after it (1) has explained the situation to the labor union or to all of its employees 30 days in advance, (2) has solicited and considered the opinions of the labor union or the employees, and (3) has reported and submitted its workforce layoff plan to the labor administrative department (in some localities an authority's approval is even required):

- 1** Restructuring pursuant to the Chinese Enterprise Bankruptcy Law;
- 2** Serious difficulties in production and/or business operation;
- 3** The enterprise switches production, introduces significant technological innovation or adjusts its business model, and still needs to reduce its workforce after amending the labor contracts; or
- 4** A material change in the objective economic conditions relied upon at the time of conclusion of the labor contracts renders it impossible for the parties to perform.

**In the course of a mass layoff, the following personnel shall be retained with priority:**

- 1** Who have concluded a fixed-term labor contract with the employer with a relatively long term;
- 2** Who have concluded an open-ended labor contract with the employer; or
- 3** Who are the sole employed person in the family with dependent family members that are elderly or minors.

If the employer intends to hire new employees again within 6 months after the mass layoff, the employer shall notify the dismissed employees and rehire them with priority under the same condition.

## Employees Specially Protected from Certain Kinds of Dismissal

In addition, the labor contract shall not be unilaterally terminated through mass layoff or due to material change in underlying objective circumstances if the employee:

- 1** Is engaged in operations that would expose him/her to occupational disease hazards and has not undergone an occupational health check-up before leaving work, or is suspected of having contracted an occupational disease and is being diagnosed or under medical observation;
- 2** Has been confirmed as having lost or partially lost his capacity to work due to an occupational disease contracted or a work-related injury sustained during his/her employment with the employer;
- 3** Has contracted an illness or sustained a non-work-related injury but the prescribed period of medical treatment has not expired;
- 4** Is a female in her pregnancy, confinement or nursing period;
- 5** Has been working for the employer continuously for not less than 15 years and is less than five years away from the legal retirement age; or
- 6** Falls into any other circumstances stipulated by laws or administrative regulations (e.g. company trade union committee's full-time members during their office term and staff representatives during the collective bargaining).

However, the labor contracts of those above-mentioned specially protected employees can still be terminated through mutual termination or for good cause (e.g. due to serious violation of the company rules) or as stipulated by law (e.g. upon employer's earlier dissolution).

## Legal Consequences for Unlawful Dismissal / Mass Layoff

If the dismissal/mass layoff would be finally deemed unlawful by labor dispute arbitral tribunal or court, in addition to the salary from the unlawful termination date, the employee is also entitled to double statutory severance (please refer to below Statutory Severance) or reinstatement depending on his own choice and whether a re-instatement is still practically possible.

## Mutual Termination

A labor contract in China can always be mutually terminated in writing without following any social plan and termination notice period. If such mutual termination is requested by the employer, the employee is entitled to a statutory severance (please refer to below Statutory Severance). In order to encourage the employee to accept a mutual termination, the employer normally would need to offer a severance higher than the statutory minimum.

When an employer uses a pre-drafted mutual termination agreement for repeated uses without substantive consultation and negotiation with the employee concerned, such agreement might be deemed form terms. In such case, among others the employer should fulfil the statutory obligations to draw the employee's attention to and (if requested) explain the terms significantly affecting the employee's interests. Otherwise, the employee may assert that such terms do not constitute a part of the relevant contract and he/she no longer needs to apply to a court or a labor dispute arbitral tribunal for revocation of such terms.

## Ending by Law due to Employer's Dissolution

In China, a labor contract shall end by law due to the employer's decision on its earlier dissolution. However, in practice, the Chinese courts indeed have ruled differently on the specific timing of employer's dissolution and the consequent ending of employment contracts: being the date of rendering dissolution resolution, or the date of constitution of the liquidation group (i.e. appointment of liquidators), or even the date of employer's deregistration.

Now the new Chinese Civil Code (in force since January 1, 2021) could be applied to clarify this issue. Pursuant to it, a legal person such as a Chinese Ltd. shall be deemed dissolved when its supreme decision-making body (sole shareholder or shareholders' meeting) makes the decision on dissolution; an unincorporated organization such as a partnership shall be deemed dissolved when its investors or founders make the decision on dissolution.

Therefore, legally speaking the termination of employment contracts due to employer's earlier dissolution should be upon the making of dissolution decision or on the dissolution date as stated in such decision but neither upon liquidation nor upon deregistration of the employer. Nonetheless, the local judicial practice in each case might still take a different view and should be double-checked.

In addition, for evidentiary purposes, a written termination notice stating the termination date, reasons (i.e. termination by law due to employer's earlier dissolution) and steps before and after the termination (e.g. arranging employees to take leave, paying severance, transfer of personal files, confidentiality etc.) should be issued to the employee concerned.

In practice, in order to avoid uncertainties, the employer might instead wish to consider entering into a written mutual termination agreement with the employee concerned (please refer to above Mutual Termination).

## Statutory Severance

In China, under certain termination circumstances an employer is obligated to pay an economic compensation (i.e. statutory severance) to the respective employee based on the number of years he/she has worked for the employer and at the rate of one average monthly remuneration for each full year he/she worked. Among others, for dismissal due to material change in the underlying objective circumstances, for mass layoff, for ending by law

upon employer's earlier dissolution, or for mutual termination as requested by the employer, the employer is obligated to pay the statutory severance to the respective employee accordingly.

There are caps for calculating the statutory severance under certain circumstances. For service years starting from/after January 1, 2008, if the respective employee's average monthly remuneration is higher than 3 times of the local average monthly salary where the employer is located ("**Cap Amount**"), the base amount for statutory severance calculation shall be capped by 3 times of the local average salary, and the number of service years after January 1, 2008 of such employee for calculating the statutory severance is capped by 12 (for details please refer to below Calculation Formula). For service years before January 1, 2008, in the cases of mutual termination, the number of such service years of an employee for calculating the statutory severance is also capped by 12.

### Calculation Formula of Statutory Severance:

Depending on the employee's joining date (before or since January 1, 2008), the statutory severance shall be calculated as follows in accordance with respective situation:

- 1 Situation I:** If the employee joined the company on or after January 1, 2008: Statutory severance = Average Remuneration (that could be capped by the Cap Amount) X No. of Working Years (that could be capped by 12)
- 2 Situation II:** If the employee joined the company before January 1, 2008: Statutory severance = the sum of the severances calculated respectively for the working years before and since January 1, 2008 (in accordance with the applicable rules respectively before and since January 1, 2008), i.e.
  - **Before January 1, 2008:** Statutory severance = Average Remuneration (no cap applicable) X No. of Working Years (that could be capped by 12 depending on the specific termination reason), plus
  - **Since January 1, 2008:** Statutory severance = Average Remuneration (that could be capped by the Cap Amount depending on the employee's average remuneration and the local average wage) X No. of Working Years (that could be capped by 12 depending on the employee's average remuneration and the local average wage)

### Definitions for the above formula:

- 1 "Average Remuneration"** refers to the employee's average monthly remuneration (inclusive of salary, bonus, allowance, overtime etc.) during the last 12 months until termination.
- 2 "Cap Amount"** is 3 times of the local average remuneration in the city where the employer is located.
- 3 "Working Years before January 1, 2008":** In general, any working period less than 1 year is deemed 1 Working Year (subject to local rules; for instance in Shanghai any working period before January 1, 2008 that is less than 6 month will not be considered for calculating statutory severance).
- 4 "Working Years since January 1, 2008":** Any working period less than 6 months is deemed 0.5 Working Year, and any working period of 6 months or more but less than 12 months is deemed one Working Year.

## Other Entitlements of Employees

The salary shall be paid until the termination date.

The social insurance and housing funds contribution shall be made and withheld by the employer until the termination date.

All accrued but unused statutory leave days by the termination date shall be compensated with 200% of the normal daily wage per day.

Should a post-contractual non-compete restrictive covenant have already been agreed upon by both parties in the course of employment, the agreed monthly non-compete compensation shall be paid to the employee after termination, unless the employer has already terminated such agreement before or at the same time of termination of the labor contract.

Not least, different localities might have different additional compensation for employees.

## Other Issues to be Paid Attention to

In practice, it is extremely challenging and risky to conduct mass layoff in China due to the complex procedures. The dismissal due to material change in the underlying objective circumstances as mentioned above also faces severe difficulties because the employer has to bear the heavy burden of proof to overcome the high statutory threshold.

Therefore, dismissal due to material change in underlying objective circumstances and mass layoff are the last resort only. Other expense-saving options should be considered at first, e.g.

- 1 Seeking national and local supports and subsidies (such as refund of unemployment insurance contributions and exemption from making pension, unemployment and work-related injury insurance contributions according to policies for the COVID-19 pandemic);
- 2 Reducing the employee's working time and salary and/or extending the salary payment cycle based on a corresponding agreement or the relevant provisions in the duly adopted company rules or collective contract;
- 3 Arranging for unpaid leave for employees or suspension of the employment based on a corresponding agreement;
- 4 Suspending the company's business operation partly or as a whole by following relevant procedures. If so, for the first 30 days the employees concerned shall be paid their normal salaries. After this first payment cycle, only the local minimum wage or living fee (depending on local rules) needs to be paid to them, unless the parties have agreed on a higher payment. This measure could also be combined with other measures such as mutual termination.

Should a redundancy nonetheless be unavoidable, an employer should consider other ending options at first, e.g.

- 1 Termination upon expiration of the fixed term;  
Termination by law (e.g. due to reaching of statutory retirement age, employer's earlier dissolution, or expiration of work & residence permit in case of a foreign employee);
- 2 Employee's resignation or mutual agreement by offering severance that is higher than the statutory minimum severance; or
- 3 Termination for good cause.
- 4

When conducting a mass layoff or dismissal due to material change in the underlying objective circumstances,

- 1** Please keep the layoff/dismissal plan strictly confidential and prevent any negative evidence that the staff might use against the company (e.g. audio or video records taken by the employees when announcing such plan or consulting employees about it);
- 2** Before implementing dismissal or mass layoff, the most important items of the company such as chops and business license shall be secured at first;
- 3** Communication and correspondence with staff and third parties (including authorities, business partners and media) shall be well prepared;
- 4** The employer shall carefully document each step taken due to the employer's burden of proof in the potential proceedings.

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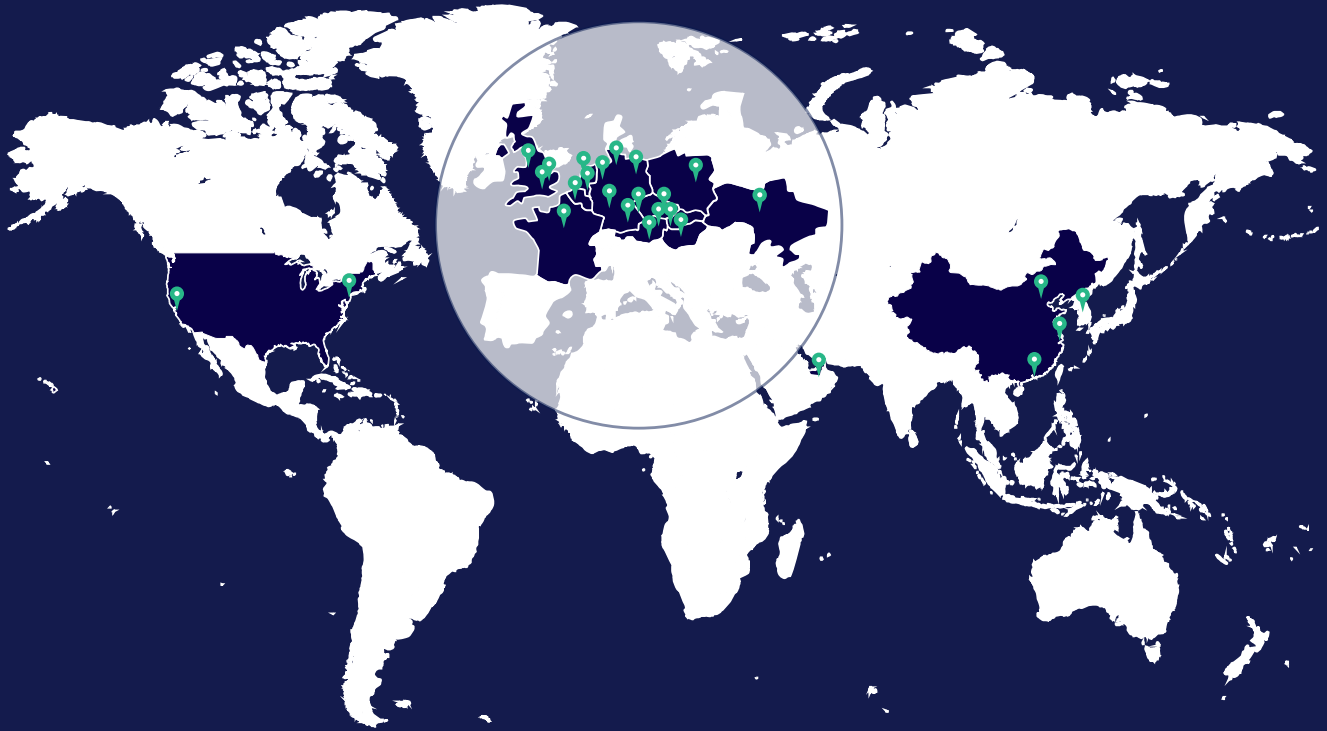
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