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CHINA UPDATE

Regulations Regarding Shenzhen Qianhai Zone and the Treatment Under CEPA

Key Points

- New cooperation zone to strengthen collaboration between Hong Kong, Shenzhen and the Pearl River Delta
- China-Hong Kong agreement makes it easier for Hong Kong enterprises to set up and run modern services businesses in the Qianhai Zone

Background

The Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone (Qianhai Zone) is to be developed as "South China's Manhattan" with the intention of strengthening the collaboration between Hong Kong, Shenzhen and the Pearl River Delta, help high-end service industries enter the mainland market and increase the international use of Renminbi (RMB).

New regulations and laws have been created by the Government of Shenzhen specifically for the Qianhai Zone.

On 29 June 2012, Hong Kong and China reached agreement on a further enhancement of economic and trade co-operation and exchanges. This agreement lowers the eligibility requirements and access criteria for Hong Kong enterprises setting up and running modern services businesses in the Qianhai Zone, leading to a finance and services market with the lead of Hong Kong.

Highlights of the Regulations

- China further relaxes the market access conditions for 21 existing service sectors of Hong Kong on the basis of the commitments on liberalisation of trade in services under CEPA, and introduces liberalisation measures in the education services sector.
- The liberalisation measures of these 22 service sectors in Qianhai Zone may be subjected to specific shareholding requirement under CEPA Supplement IX.
- CEPA Supplement IX provides mutual recognition of professional qualification between real estate appraisers on the Mainland and general practice surveyors in Hong Kong, and between cost engineers on the Mainland and quantity surveyors in Hong Kong.
- CEPA Supplement IX also provides deeper co-operation between the financial markets on the Mainland and in Hong Kong with the following measures:
  - Supporting listing of Chinese enterprises in Hong Kong by improving the Mainland's overseas listing requirements.
  - Creating favourable conditions for Mainland enterprises, especially SMEs, to raise capital through listing in overseas market.
  - Exploring ways to facilitate co-operation between futures markets.
  - Facilitating Hong Kong's long-term capital investing in the Mainland capital markets by lowering eligibility requirements for Hong Kong's financial institutions to apply for Qualified Foreign Institutional Investor status.
  - Supporting qualified Hong Kong financial institutions in setting up joint venture securities companies, fund management companies and futures companies on the Mainland.
- The Government of Shenzhen has made regulations to facilitate the development of the Qianhai Zone including the setting up of a:
  - Governing authority – for developing, constructing, running and managing the Qianhai Zone. As a first step, this authority should implement CEPA Supplement IX.
  - Supervisory body – for monitoring and supervising the activities of the Qianhai Zone governing authority.
  - Banking and other financial services supervisory body.
  - Co-operation body for Shenzhen and Hong Kong in the Qianhai Zone.
  - Globally recognised business registration system.
  - System for administrative review, with focus on creating organizations for handling commercial disputes.

- There will be tax reform for the modern services industry in the Qianhai Zone (e.g., waiver of business tax, preferential corporate tax rate at 15 percent and discounted individual income tax).
- The government of Shenzhen is encouraged to cooperate with Hong Kong in relation to telecommunications, education, medical services and social welfare so as to provide a good working and living environment for the people in the Qianhai Zone.

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Amendment to Labour Contract Law on Agenda

Key Points

The draft Amendment to Labour Contract Law:

- Limits the scope of positions for employee secondment
- Sets higher market access threshold for secondment services company
- Further emphasizes "same work, same pay" policy
- Provides new administrative sanctions for violations of laws

Background

On 6 July 2012, the Standing Committee of the National People's Congress reviewed for the first time the draft Amendment to Labour Contract Law. If it comes into force, the amendment will change rules regarding employee secondments and secondment services companies.

Highlights of the Regulations

- Employees can only be seconded for temporary, auxiliary or substitute positions.
- Formation of a secondment service company requires minimum registered capital of RMB1 million and approval from the labour bureau.
- The policy of "same work, same pay" must be specified in contracts.
- Violation may result in fines, confiscation of illegal incomes and revoking of approval.

Summary

As a result of the amendment, secondment services companies must:

- Only second employees to temporary, auxiliary or substitute positions.
- Have a registered capital of no less than RMB1 million and a sound labour secondment management system. They shall obtain approval from the labour bureau before registration with AIC.
- Specify the policy of "same work, same pay" in the contract between the secondment services company and the employee and in the contract between the secondment service company and the employer.

Final Thoughts

The practice of outsourcing labour will be strictly regulated if the draft amendment is put into force. It may be a problem for a secondment service company to second employees to a representative office, as most of the positions offered by representative office are not temporary, auxiliary or substitute.

If a secondment services company carries out secondment business without approval from the labour bureau, the business will be shut down. In addition, the illegal incomes will be confiscated and fines of up to five times the value of the illegal incomes will be imposed on the secondment services company.

In case of a serious violation, a fine ranging from RMB5,000 to RMB10,000 shall be imposed on the secondment services company for each employee it concerns and any approval granted by the labour bureau may be revoked.

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Introduction to the Exit-Entry Administration Law of the People's Republic of China

Key Points

- New law will alter exit-entry procedures for citizens of China and visitors
- Foreigners working in China must obtain the proper permits

Background

The Exit-Entry Administration Law of the People's Republic of China (New Law) will take effect 1 July 2013, abolishing current laws on exit-entry administration. The New Law will apply to exit and entry of both visitors to and citizens of China.

Changes to the Current Sysytem by the New Law

Entry Visa System

- Under current laws, an ordinary visa must be applied for if entering China for work, study, family visit, tourism and business. The New Law keeps this list and adds the additional reason "talent introduction".
- Chinese companies or individuals issuing invitation letters to foreigners shall be responsible for the authenticity of the invitation letter. A fine will be imposed upon the company or individual if the invitation letter cannot be authenticated.

Stay and Residence System

- Visitors holding visas with an annotation allowing a residence permit after entry should apply for this permit within 30 days of entering China. Foreigners must apply to the relevant authority located where the visa holder intends to reside and must provide finger prints.
- There are two types of residence permit: "residence permit of work type" (valid for between 90 days and five years) and "residence permit of non-work type" (valid for 180 days to five years).
- When visitors to China stay in hotels or similar accommodations, the accommodation provider or visitor must register with the local public security bureau within 24 hours of checking in.

Foreigners Working in China

Foreigners working in China must have a work permit and the correct residence permit. In addition, a foreigner will be regarded as working illegally in China if he or she:

- Works in China without obtaining both a work permit or a residence permit of the work type;
- Works beyond the scope as specified in the work permit; or
- Is a student and works beyond the specified scope of jobs or period in the permits.

These laws are in place whether the work is paid or not, and a fine will be imposed on companies or individuals hiring foreigners illegally.

Increased Punishment on "San Fei" Foreigners

The new law increases punishment on "San Fei" foreigners, who are foreigners who illegally enter, stay or work in China. Citizens, companies or other entities must report to the local public security bureau promptly once they find any San Fei foreigners.

Final Thoughts

This New Law will bring substantial changes to the exit-entry regulations in China. Though repealing the old laws, it essentially adds to and enhances them with the intention of attracting more overseas talent.

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Supreme Court's Draft Interpretation on Labour Issues – Interesting Developments on Enforceability of Noncompetition Clauses

Key Points

- New rules could make it more costly for employers to enforce noncompetition clauses
- If a clause fails to provide a compensation amount for the noncompetition obligation, the court will not support employers' enforcement requests
- Enforceability of noncompetition clauses is now tied to cause of termination
- Final adopted rules may address remaining questions related to invalidation of clauses and performance of the noncompetition obligation

Background

On 27 June 2012, the Supreme People's Court issued a draft of "Interpretation (4) on Several Issues Concerning the Application of Law to the Hearing of Labour Dispute Cases" (Draft Interpretation) for public comment.

The Draft Interpretation includes 18 articles discussing issues including court jurisdictions, termination and severance pay, employers' internal rules, noncompetition clauses, employment contract amendments and foreigners working in China.

The Draft Interpretation devotes four articles to noncompetition clauses, an issue creating a lot of disputes between white collar employees and their former employers.

Compensation Amounts

The Draft Interpretation clarifies that if the noncompetition clause fails to provide the compensation amount for the noncompetition obligation, the court will not support the employer's request to enforce the obligation. But if the employee performs the noncompetition obligation, even if there is no agreed-upon compensation amount, the court will support the employee's claim for compensation, which will be calculated based on the average monthly salary of the 12-month period immediately before the termination (under the current practice, the court designates an amount of 20 to 60 percent of the normal monthly salary). The Draft Interpretation further provides that while the noncompetition clause itself is enforceable – i.e., it has provided the compensation amount for the noncompetition obligation – if the employer fails to pay the compensation for more than one month, the clause is no longer enforceable unless the employee agrees.

Cause of Employment Termination

The Draft Interpretation also ties the enforceability of the noncompetition clause to the cause of the termination. If employment is terminated by mutual agreement, the clause will continue to be valid and enforceable unless the employer and employee specifically agree to terminate it. If the employer

terminates employment wrongfully or the employee terminates employment because of the employer's violation of law (termination based on Article 38 of the Labour Contract Law), the employer is not entitled to request that the noncompetition obligation be enforced unless the employee agrees. Likewise, for wrongful termination by the employee or termination by the employer due to the employee's fault, the employee must perform the noncompetition obligation if the employer requests him or her to do so.

It is clear that the Supreme Court's theory is no one should benefit from his or her own wrongdoing. Such articles in the Draft Interpretation also indicate that the non-defaulting party has the option to enforce the noncompetition clause in a wrongful termination case.

Terminating Noncompetition Clauses

The Draft Interpretation further provides that termination of a noncompetition clause must be done through mutual agreement. The only exception is the employer terminating the clause unilaterally by giving 60 days prior notice if the termination was related to the public disclosure of trade secrets or confidential information regarding intellectual property rights; in this case the noncompetition obligation becomes unnecessary. This is different from the current practice in some cities – for example, Beijing – where the employer has the option to waive and release the employee from the noncompetition clause by giving written notice.

Final Thoughts

Noncompetition clauses are viewed as a way to protect the employer's interests. Although the Labour Contract Law makes it clear that such a clause should apply only to senior-position employees or others that have a confidentiality obligation, in practice it is commonly inserted into the employment contract of ordinary white collar employees. The Draft Interpretation seems to try to balance the situation by making it more costly for the employer to enforce the clause (i.e., courts can order the employer to pay a higher rate of monthly compensation, noncompetition clauses can be invalidated if the employer fails to provide compensation and the employer may not unilaterally waive or terminate the clause) so it will be more careful when considering whether to include it in the employment contract. However, the four articles proposed in the Draft Interpretation also raise questions regarding whether an employer that does not want to enforce a noncompetition clause can still easily get out of it simply by not paying the agreed compensation. The Draft Interpretation makes it clear that if the employee performs the noncompetition obligation the employer must pay based on the average monthly salary. However, the next question is what will be considered sufficient evidence of the employee's performance of the noncompetition obligation and whether the fact that the employee does not work for any employer during the noncompetition period is sufficient.

It will be interesting to see whether these questions are answered in the final adopted interpretation.

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