



HOW TO LEGALLY TERMINATE EMPLOYEES FOR COMPANIES IN CHINA IN THE CONTEXT OF ECONOMIC DOWNTURN AND BUSINESS RESTRUCTURING

George Wang Duan & Duan

Due to the complexity and volatility of the global economic situation and increased market uncertainty, many companies in China have had to consider layoffs as a countermeasure in the face of economic downturn and business restructuring. This article will discuss how companies in China can legally terminate employees under Chinese labor law in this context.

In the United States, labor relations are primarily governed by the principle of at-will employment. U.S. companies have the right to unilaterally terminate employment at any time for legitimate reasons, and federal law does not require them to pay severance and even if they conduct mass layoffs, the burden of economic costs under the law is not heavy. Unlike the employer-friendly approach in the United States, Chinese labor laws give priority to the rights and interests of employees. In China, companies are required to comply with the law when dismissing employees. Failure to do so may result in legal consequences.

In general, there are two legal ways for companies to terminate an employee:

through mutual agreement or unilaterally by the company.

TERMINATION BY MUTUAL AGREEMENT

Terminating employment through mutual agreement with the employee is considered the most optimal approach to mitigate legal risks.

Specifically, the company negotiates with the employee and provides economic compensation for termination. The legal criterion for determining this compensation is based on a formula of "N x monthly salary," where "N" denotes the number of years the employee has been with the company and "monthly salary" is the average salary earned by the employee in the twelve months preceding the termination of their employment contract.

In the event that the employee has worked less than six months, the value of N is 0.5, and if the employee has worked exceeding six months but less than one year, the value of N is 1. Additionally, if the

employee's monthly salary surpasses three times the average monthly salary of employees in the previous year as stipulated by the regional government where the company operates, then the company is required to pay compensation to the employee at a rate of three times the average monthly salary of employees, and the maximum duration for which economic compensation is payable is capped at twelve years.

In practice, the company normally pays the employee N+1 economic compensation, but the specific amount is often closely related to the employee's personal decision (the company must compensate 2xNx monthly salary if the employee is forced to terminate the company against their will). Therefore, in cases of non-cooperation by the employee, it may even be necessary to pay a compensation higher than N+1.

After the company pays the compensation, the company signs an amicable agreement with the employee terminating the employment relationship, and even if the employees express regret and demand

to resume the employment relationship or receive compensation, it is improbable that the arbitration tribunal or court will support their claim.

UNILATERAL TERMINATION BY THE COMPANY

If the company and the employee cannot reach an agreement on the termination of the employment relationship, the company has the right to unilaterally terminate the employee in accordance with the relevant legal provisions. This can be divided into the following three scenarios:

A. Fault-based Termination

Firstly, if employees are at fault for any of the following, the company has the right to terminate them immediately without paying severance: (i) failure to pass the probationary period; (ii) serious violation of the company's regulations; (iii) severe negligence or misconduct resulting in significant damage to the company; (iv) found guilty of criminal liability.

B. No-fault Termination

Secondly, if the employee, through no fault of his or her own, is still unable to perform his/her job duties after being trained or reassigned, or if the initial employment contract cannot be continued due to significant changes in the objective circumstances, the company may terminate him/her employment contract but is required to provide a minimum of 30 days written notice in such instances.

In practice, the most common reason for dismissal is the inability to continue performing the labor contract due to significant changes in the objective circumstances, in which significant changes in the objective circumstances recognized by the law generally refer to any of the following situations: (a) External objective factors, such as force majeure, changes in law or policy, etc.; and (b) The company's business restructuring, which may include adjustments to the organizational structure, the withdrawal of a department, the relocation of the business address, mergers and reorganization, restructuring, asset transfer, etc.

In such circumstances, the company must initially negotiate with the employee to adjust his/her job position, workplace or other arrangements, and only when both parties fail to reach an agreement can the company terminate the employee. In these cases where the employees are not at fault, the company is obligated to provide them with a N+1 compensation.

C. Economic Layoffs

Thirdly, a company may opt for economic

layoffs during particular operational difficulties wherein it could lay off more than 20 or 10% of its employees at one time.

Compared with other methods, the benefits of economic layoffs are twofold: firstly, they allow for large-scale layoffs to be achieved in a relatively short period of time with minimal economic costs (a N+1 compensation); secondly, the layoff plan can be implemented directly once the PRC Human Resources Authority has approved and there is no legal risk associated with the layoffs. However, obtaining such permission from the PRC Human Resources Authority requires meeting stringent conditions and procedures.

In regard to "the operational difficulties," these generally refer to any of the following: (i) the company is on the verge of bankruptcy or has undergone bankruptcy reorganization; (ii) the company is experiencing significant challenges in production and operations; (iii) the company has implemented changes to its production, business methods etc., but even after modifying the labor contract, the company still needs to lay off employees; (iv) the initial employment contract cannot be continued due to significant changes in the objective circumstances. In terms of procedure, the company should first explain the situation to the labor union or all employees 30 days in advance and consider their feedback ("democratic procedure"). Subsequently, the layoff plan will be submitted to the PRC Human Resources Authority ("submission procedure"). Upon the completion of the submission procedure and approval of the plan, the employees may be terminated.

Furthermore, it should be noted that No-fault Termination and Economic Layoffs do not apply to female employees who are pregnant, on maternity leave, or breastfeeding; employees who suffer from occupational diseases; or employees who have worked continuously for the company for 15 years or more and less than five years from the statutory retirement age. In such cases, the dismissal may be deemed illegal, and the company must pay a 2N compensation.

SALARY REDUCTION

Salary reduction is another countermeasure that can be considered in addition to terminating an employee. When implementing a salary reduction program, it is essential for a company to adhere to the prescribed processes to ensure the program's legality and reasonability.

Based on our practical experience, we recommend the following outlined process. As a first step, the company should formulate a new salary program or performance reform program to adjust salaries in accor-

dance with the actual business situation. For example, the company may opt to divide the employees' fixed salary into two components: a basic salary and a performance bonus, and the performance bonus may be partially or fully issued at a specified time point after the employee passes the appraisal.

The company should then implement the salary program or performance reform program in accordance with a series of democratic procedures. The company must initially convene a general meeting of all employees or employee representatives to discuss and vote on the adoption of the program. Following the adoption of the program, the company must make a public announcement of the new program and obtain a written statement from employees confirming their awareness of the program. Once the aforementioned democratic procedures have been completed, the company's salary reduction program for employees will be deemed reasonable, legal, and enforceable.

Finally, it is imperative that the company adhere to the terms of the new salary program in a strict and unwavering manner. Failure to do so will result in the program being deemed invalid, and the arbitration tribunal or court may require the company to reimburse the difference in salary to the employees.

In conclusion, companies in China have a variety of legal options at their disposal to terminate employees. Companies may terminate an employment contract either by mutual agreement with the employee or unilaterally if the legal conditions are met. Furthermore, as a countermeasure, companies are also entitled to adjust the wages of their employees in a reasonable, legal and enforceable manner.



George Wang is the managing partner of [Duan & Duan Law Firm](#) in Shanghai, China. He holds a Magister of Juris from Oxford University and was awarded a Chevening Scholarship from the UK government. He has represented foreign investors, including multiple Fortune 500 companies, to handle over 100 FDI and M&A projects. He serves as a member of the Foreign Affairs Committee of the Shanghai Bar Association and legal counsel of the Shanghai Foreign Investment Association. He was also awarded as Foreign Leading Talent, the "A-List" 100 Lawyers of China Business Law Journal, and Chambers "Leading Lawyer" in Corporate & Commercial Practice 2022.