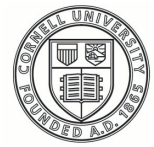

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China Employment Law Update - August 2013

Baker & McKenzie

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Abstract

[Excerpt] On July 31, 2013, the Shanghai No. 1 Intermediate People's Court, before a trial on the merits of the case, issued a preliminary injunction order against a former employee of the Chinese subsidiary of a U.S.-based pharmaceutical company. The injunction order restrained him from disclosing, using, or allowing others to use certain documents containing trade secrets that he downloaded from the company's database without authorization. In addition, the court also issued an asset preservation order to freeze the ex-employee's real property and bank account pending the trial.

The former employee admitted he downloaded valuable, highly confidential information to his personal USB drive and personal computer. The downloading of such information was not justified by work-related needs, and violated his confidentiality agreement and the company policies. He later refused to cooperate with the company to delete such information from his personal device and computer. The company terminated his employment, and filed a civil action against him. The court acknowledged that there was a threat of irreparable damage to the company in the event of an unauthorized disclosure or misuse of the alleged trade secrets, and that preliminary injunction and asset preservation remedies were therefore warranted in this case.

This is a landmark case as, according to Chinese media, it is the first case anywhere in China where a party successfully obtained a preliminary injunction and asset preservation order in a trade secrets dispute since the newly amended PRC Civil Procedure Law took effect on January 1, 2013. The amended Civil Procedure Law specifically allows for preliminary injunctions and asset preservation relief in all civil cases. In the past, such remedies were only specifically allowed in patent, trademark and copyright infringement cases. Trade secrets were therefore not well protected under the previous judicial practice, since companies would have to wait until they actually suffered harm before they even had a basis for bringing a claim, and then would have to wait for final judgment (which could be up to one year or more later if all appeals are exhausted) before obtaining any relief. This case thus sets a milestone for trade secrets protection (or breach of confidentiality) cases. It remains to be seen whether the court would enforce the same measures in a non-compete case, which is another type of employer-employee dispute in which preliminary injunctive relief would help the employer prevent further damage resulting from the employee's alleged breach of duties.

From an employee management perspective, employers should pay more attention to their company policies and agreements related to protection of confidential information as robust company policies and agreements may help the company seek injunctive relief even before the trial on the merits commences.

Keywords

Baker & McKenzie, China, employment law

Comments

China Employment Law Update

People's Republic of China

BAKER & MCKENZIE

August 2013

Court Issues First Ever Preliminary Injunction in Trade Secrets Case

On July 31, 2013, the Shanghai No. 1 Intermediate People's Court, before a trial on the merits of the case, issued a preliminary injunction order against a former employee of the Chinese subsidiary of a U.S.-based pharmaceutical company. The injunction order restrained him from disclosing, using, or allowing others to use certain documents containing trade secrets that he downloaded from the company's database without authorization. In addition, the court also issued an asset preservation order to freeze the ex-employee's real property and bank account pending the trial.

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From an employee management perspective, employers should pay more attention to their company policies and agreements related to protection of confidential information as robust company policies and agreements may help the company seek injunctive relief even before the trial on the merits commences.

MOHRSS Issues Draft Labor Dispatch Regulations for Public Comment

The Ministry of Human Resources and Social Security ("**MOHRSS**") finally issued the draft *Labor Dispatch Regulations* in August 2013 for public comment; according to Chinese media reports, originally MOHRSS had planned to pass the *Labor Dispatch Regulations* by July 1.

The draft *Labor Dispatch Regulations* include some significant provisions that would help clarify certain matters left unclear in the amended Employment Contract Law ("**ECL**"). For example, some guidance is provided regarding how to distinguish a true outsourcing arrangement from a disguised labor dispatch arrangement. The draft also provides guidance on how to handle the termination of dispatched workers in the event that the host entity goes through a restructuring. In addition, the draft regulations more clearly provide dispatched workers with a right to sue their host entity for *de facto* employment if the host entity uses labor dispatch arrangements outside the allowable scope.

Most significantly, the draft regulations set the maximum percentage of employees that may be hired through labor dispatch. Under the draft, dispatched workers used in auxiliary positions may not exceed 10% of the total workforce of the company (including both the directly hired employees and the dispatched workers used in auxiliary positions). There are no numerical or percentage limitations for dispatched workers hired for temporary and substitute job positions.

There is still no indication when the *Labor Dispatch Regulations* will finally be passed, or whether the government will make any further significant changes to the draft.

Implementing Regulations Issued for New Law Governing Entry and Exit of Foreigners

The long-awaited implementing regulations to the *Law of the People's Republic of China on Entry and Exit Control* have been issued by the State Council. The regulations, which will take effect on September 1, 2013, introduce new visa categories, provide guidance on audits by the local public security bureaus, and address employer obligations when hiring foreign workers.

In particular, the newly created M visa is to be used for commercial trade activities and is expected to be the appropriate visa category for business visitors. The R visa has been created for high-level talent and specialists

whose skills are in short supply in China. The requirements for high-level talent classification are expected to be defined by relevant PRC ministries.

Local public security bureaus ("PSB") responsible for processing Residence Permit applications may conduct verification through various methods including interviews and onsite visits. Employers sponsoring foreign workers must plan for such audits during Residence Permit processing.

With regards to foreign student internships, the new regulations stipulate that foreign students holding Residence Permits for study purposes may participate in work-study programs and off-campus internships by obtaining school approval and applying for PSB approval to be granted via an endorsement in the Residence Permit. The PSB endorsement will be specific, identifying the internship location and period, at a minimum.

For more details on the new implementing regulations, please see our client alert on this topic.

Shanghai High Court Issues Guidance on Employee Inventors' Remuneration

On June 25, 2013, Shanghai High People's Court issued a *Trial Guidance on Rewards and Remuneration for Inventors and Designers of Service Inventions* (**"Remuneration Guidance"**).

The Remuneration Guidance clarifies that an inventor or designer of a service invention created in China is entitled to rewards and remuneration according to the *Patent Law of the PRC* and its implementing regulations (collectively, "**Patent Law**"), regardless of whether the employer files for a patent within or outside China.

The Remuneration Guidance states that the rewards and remuneration can be in the form of cash compensation, stocks, options, promotion, salary increase or paid leave, provided that the actual benefits offered to the employee are reasonable. Most significantly, the Remuneration Guidance stresses that an employer can offer rewards and remuneration lower than the statutory default amounts or in one lump sum, as long as it reaches an agreement with an employee, or has adopted a policy through the "employee consultation procedure". The court shall not strike down the agreed amount unless it is extremely unreasonable. In the absence of agreement or company policy, the employee inventor or designer will receive rewards and remuneration at the statutory default amounts.

The above guidance in particular confirms the importance of executing valid inventor compensation agreements with employees who may create patentable inventions, or adopting company policies dealing with inventor compensation through the required consultation process stipulated in Article 4 of the Employment Contract Law. Without valid agreements or policies, companies will be forced to pay to employee-inventors the potentially large default amounts of remuneration stipulated in the Patent Law.

According to the Remuneration Guidance, only inventors or designers of the entity who own the patent are entitled to rewards and remuneration. Therefore, if the employee of a commissioned entity creates a patentable invention and if the commissioning entity has the sole right to patent the invention under the entrustment agreement, the employee will not be entitled to rewards or remuneration because his/her employer (i.e. the commissioned entity) does not and will not own the patent. The Remuneration Guidance also provides that a dispatched employee can claim for rewards and remuneration for any service inventions he/she creates while being dispatched to the employing unit.

Finally, the Remuneration Guidance makes it clear that any dispute over the reward and remuneration claims in relation to a service invention shall be treated as a patent dispute instead of an employment dispute. Therefore, such disputes shall be brought to courts with jurisdiction over patent disputes, instead of employment dispute arbitration commissions.

Guangdong Province Issues New Notice on Payment of Union Fees

On July 1, 2013, the *Interim Measures of Guangdong Province on Administration of the Collection of Union Fees* (**"Guangdong Fee Measures"**), which was jointly issued by the Guangdong Federation of Trade Unions, the Guangdong Taxation Bureau and the Guangzhou Branch of People's Bank of China, came into effect. In light of the new measures, local union officials and tax authorities have been putting pressure on companies to establish a union or pay a union preparation fee.

The Guangdong Fee Measures provide that the employer should pay a union preparation fee (equivalent in amount to the union fee), if it has not established a labor union within 6 months after the company's establishment or starting operations. However, the legal authority of the provincial tax bureau and union officials to impose a union preparation fee on companies without unions is unclear, since there are no regulations passed by the local people's congress requiring companies to pay a union preparation fee. Before agreeing to establish a union or to pay a union preparation fee, employers in Guangdong Province should pay attention to what kind of enforcement actions will be taken and what position the courts will take on this issue, and be prepared to respond to pressure or queries from tax and union officials in the coming months.

Evidence Obtained from Employee's Work Email Not Admitted by Court

Recently, the Guangdong Foshan Intermediate People's Court ruled in a termination case that evidence taken from an employee's work email was not admissible as evidence.

In this case, the company conducted an investigation of the employee by checking the employee's work email without informing him. After

the investigation, the company alleged that the employee had seriously violated the company's rules and regulations, as the investigation indicated that the employee had disclosed the company's business secrets to another company via email and the employee had sent pornographic images to colleagues through email, which the company defined as harassment. As a result, the company terminated its employment relationship with the employee. Later, the employee claimed that he was illegally terminated and should be reinstated. The employee also claimed that the company should give an apology to him and rehabilitate his reputation. The trial court ruled that the termination was unlawful but dismissed the apology and reputation rehabilitation claims. The Foshan Intermediate Court affirmed the judgment on appeal.

The employee had signed a Code of Ethics, which includes a provision stating that "all the communication data and information you send or receive using the company's facilities or property during employment are company property, rather than personal communication" and "the company reserves the right to monitor all the communications, including the use of Internet". Based on this agreement, the company argued that the email is the company's property, not the employee's private email. Nevertheless, the court opined that every citizen is entitled to freedom of correspondence and this right cannot be deprived without due procedure. Although the email address had the company's name at the end and it was sent through the work email system, the company still violated the employee's privacy, as this email account could only be logged into with a password set by the employee and was personally used by the employee. Therefore, the company had violated the employee's rights by checking the employee's email without his permission, and the evidence obtained in this way cannot be admitted as evidence.

This case shows that even with a provision in company policies giving the company the right to monitor work email, some courts may still hold that checking employees' email without their consent violates employees' rights to privacy of correspondence and evidence obtained in this way potentially may not be admitted by the court. Not all courts would necessarily support such an employee-friendly position. If this type court's position becomes more widespread among the courts, it would create significant additional hurdles to employer investigations of potential misconduct.

Termination of Employee for Refusing Work Location Change Ruled as Lawful

In a recent case reported on August 1, 2013, the Shanghai Jing'an District People's Court dismissed an employee's claim for compensation for unlawful termination after he was terminated for refusing to work in another location despite being instructed to do so.

In January 2012, the employee, a gym instructor, was informed that he would be re-assigned from the company's Lujiazui facility to its Daning facility (both are located in Shanghai municipality, approximately 12

kilometers apart) as of February 1, 2012, with his position and salary unchanged. However, the employee didn't follow these instructions and continued working in Lujiazui. The employer then issued a warning letter to him about his absenteeism and required him to report to Daning branch on February 6, 2012. On February 10, the employer terminated him for being absent from work for more than 2 days, which was considered a serious violation of company rules based on the company's policies. According to the report, the employee's employment contract specified the work location to be Shanghai and expressly states that the employer has the right to assign the employee to other branches in Shanghai on the basis of work demands.

After an unsuccessful claim in front of a local arbitration committee, the employee brought the case to the court, claiming RMB 21,000 for unlawful termination. The court rejected his claim based on the following reasoning:

(1) The new work location is also located in Shanghai, which is in accordance with the employment contract;

(2) Both branches are in downtown, and thus there will not be any material effect on the employee's work or life; and

(3) The employer has reminded the employee and offered him an opportunity to correct the misconduct.

Since the employee's refusal to abide by management instructions was not justified, his conduct constituted unexcused absenteeism, and therefore the termination was lawful.

This case shows that courts are willing to allow employers some flexibility (though not total flexibility) in terms of reassigning employees from one work location to another, provided that the employment contract allows for such flexibility. Companies in those industries (such as retail) that need to regularly reassign employees to different locations in the same city should therefore carefully draft their employment contracts to maximize their flexibility.

Court Orders Company to Refund Penalty Imposed on Employee for Theft

Recently, the Rugao Municipal People's Court in Jiangsu Province reportedly ordered a shipping company to refund to its employee the payment of a fine, in the amount of RMB 15,000, which had been imposed on the employee for stealing the company's copper lines (with the assessed value being RMB 392). The employee, an electrician of the company, was caught taking away the company's copper lines by secretly putting them in his personal bag.

In its decision, the court relied on the PRC Constitution, which states that a citizen's personal property is protected from infringement, and the Law on Legislation and the Administrative Sanctions Law, which only allow laws and regulations to impose property-related penalties on individuals.

In addition, the court held that under the Employment Contract Law, employers may claim against employees for the damages caused by employees but are not allowed to impose penalties on employees. Therefore, absent evidence proving the company's economic loss, the court found that the company lacked legal basis to punish the employee for theft and ordered a refund of the penalty.

This case shows that fixed economic penalties against employees that are stipulated in company rules may not be enforceable, and that companies are generally only to claim compensation from employees commensurate with the actual economic harm suffered.

Employee Put on Leave with Minimum Salary Deemed as Taking Annual Leave

In a recent case reported in Shandong on July 17, 2013, a local intermediate court dismissed an employee's claim for compensation for unused annual leave on the ground that the company had put the employee on leave from time to time and paid the employee the local minimum wage during such leave. Therefore, the employee should be deemed to have taken up all her annual leave entitlements during such paid leave periods.

The employee joined a media company as a project-based employee in 2009. According to her employment contract, if there are no sufficient work assignments in the company, the company may put her on leave and pay her the local minimum wage. During her employment, the company put her on leave from time to time during slow periods in business. In July 2012, her employment with the company was terminated. After termination, the employee sued the company alleging that she never took any paid annual leave during employment, and therefore she should be compensated for her unused annual leave entitlements.

The labor arbitration tribunal ruled against the employee. It found that during employment, the employee was put on paid leave from time to time. Even though the pay during such leave periods was lowered to the minimum wage standard, it should still be recognized as "paid leave." Therefore, the company should be deemed to have arranged the employee to take annual leave during low periods in business. The disgruntled employee appealed the case to the court of first instance and then to the court of appeal, both of which sustained the ruling of the arbitration tribunal and dismissed the claim of the employee.

70 Year Old Worker Ruled to be an Employee

On August 12, 2013, the Jiangxi Anfu County People's Court ruled in favor of an individual who worked for a school continuously without any break after reaching the statutory retirement age (i.e., 60 years old for men), and held that he should still be deemed to have an employment relationship with the school.

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Should you wish to obtain further information or want to discuss any issues raised in this newsletter with us, please contact:

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In this case, the individual started working at the school in 1999, and after he reached 70 years old in March 2013, the school unilaterally terminated him. During litigation, the school claimed that the worker's employment should have been deemed to have automatically ended once he reached the statutory retirement age, and thus he would not be entitled to severance pay. The court, however, held that the worker's employment relationship with the school should still be deemed to exist, because the school failed to file a retirement application for him to receive pension, and arranged for him to continue working.

The national law is not entirely clear whether the employee's employment would automatically end if the employee reaches the retirement age but does not apply for retirement pension benefits. The above case shows that the practical risk would exist in such circumstances, and is also in line with recent Shanghai court guidance. Companies are therefore recommended to apply for retirement for employees who reach the retirement age, even if they intend the employee to keep working at the company. In such case, the company would be deemed to only have a labor service relationship with the worker instead of an employment relationship, and avoid all the special protections that employees are entitled to.