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## labor and employment lawflash

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### China to Strictly Regulate Secondment/Staffing Business Model

*Amendments to the PRC Labor Contract Law take effect on July 1, adding limitations on employment structures.*

On July 1, 2013, amendments to the People's Republic of China (PRC) Labor Contract Law will take effect. The amendments increase the regulation of staffing and labor service businesses and discourage the use of secondment arrangements to avoid employer-related liabilities. The new law was published on December 28, 2012 and is an important development in China's business community.

In recent years, increasing numbers of labor-intensive businesses, including state-owned banks and large multinationals, have used secondment services provided by staffing firms due to the difficulties involved in terminating employees and increased compliance costs in China. The secondment arrangements became attractive options among employers because the termination of such an arrangement was not subject to the numerous restrictions set forth in the labor law and regulations and avoided triggering severance obligations.

In light of the Chinese government's amendments to the PRC Labor Contract Law, companies with operations in China should keep in the mind the below major requirements when formulating or executing compliance plans.

#### Qualification of Staffing Firms

To engage in a staffing business for the provision of secondment services, a company must meet the new law's requirements, which include a minimum registered capital of at least RMB\$2 million. In addition, a company must apply for a special permit before conducting any staffing business. As the law is silent on the qualifications of an applicant to obtain such a permit, the approval authorities have broad discretion. It is possible the Chinese government will control the number of service providers in a particular geographic area by limiting the number of permits issued. In practice, firms without permits may structure their business models as outsourcing businesses by arguing that they are not providing staffing services. However, because the distinction between "secondment" and "outsourcing" is not defined in any law or regulation, the regulatory authorities may treat the outsourcing model as secondment in substance and thus require a permit.

#### Equal Work, Equal Pay

The new law requires that the recipients of secondment services compensate the secondee for his or her services on the principle of "equal work, equal pay." Although this concept has been in existence since the promulgation of the PRC Labor Law in 1994, it is not a defined term in any labor regulation, including the new law. Traditionally, benefits and other nonsalary items, such as equity incentive awards, have not been considered when applying the principle of equal work, equal pay. It remains to be seen how the courts and labor arbitration organizations will interpret the principle in the context of the new law.

#### Limitation on the Role of Secondees

The new law expressly states that, as a general principle, employers should hire employees through signed labor contracts and that secondment can be used only if the position is of a temporary, auxiliary, or replaceable nature.

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A position will be treated as temporary if it lasts no more than six months, but it is not clear whether the secondment term can be renewed upon expiration. “Auxiliary positions” are defined as noncore business positions without further explanation. In practice, it may often be very difficult to distinguish between core and noncore positions. For instance, while it can be argued that only bankers are core to the banking business, it can also be asserted that in-house lawyers should be core personnel as well because of their role in controlling and managing risks, which is critical to banks. The new law defines “replaceable positions” as those left vacant because the formal employees are on leave for personal or business reason, but it is not clear if replacement positions can be renewed.

## Percentage Limitation on the Number of Secondees

The new law requires employers to strictly limit the number of secondees to a certain percentage of the total number of personnel (including secondees). Specific percentages will be announced by the State Council. It is generally understood that the percentage should be within a 10% to 30% range. A literal reading of the language of the new law suggests that any percentage limitation should be in addition to the requirement that the positions for secondees should be of a temporary, auxiliary, or replaceable nature. Thus, an employer may not argue that it complies with the law by limiting the number of secondees below the maximum percentage, regardless of the nature of a secondee’s position. In practice, however, employers or regulatory authorities may take the percentage cap as a safe harbor due to the difficulties of defining the nature of a secondee’s position.

## Consequences of Breach

For staffing firms without a permit, the Chinese government may take away all illegal revenue and impose monetary penalties of up to five times the amount of the revenue. If a staffing firm or employer fails to comply with the law, the labor regulatory authority will order it to take corrective measures. A per person penalty ranging from RMB\$5,000 to RMB\$10,000 will be imposed if no remedial measures are adopted by the employer or staffing service provider. The new law is silent on whether a secondee may request that the employer convert him or her into a formal employee if the employer is found to be noncompliant. If the answer is no, what will happen to the existing secondment? Should the parties terminate the secondment and should the actual user of the employee’s service formally employ someone for the same position? May the secondee have a right of first refusal if the actual user is required to do so? These and other similar questions remain to be answered by further implementing rules from the State Council or judicial interpretation from the Supreme People’s Court.

## Contacts

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