

24/06/2021

## The Importance of Labour Internal Rules in China

Managing labour relationships in China is complex. The legal environment in China provides many labour laws and regulations, governing various aspects of employment. Most of those laws and regulations only provide general principles regarding human resources management and can vary by municipality.

The Labour Law of the PRC published on January 1<sup>st</sup>, 1995 (the “**Labour Law**”) and the Labour Contract Law of the PRC published on January 1<sup>st</sup>, 2008 (the “**Labour Contract Law**”) indicate that employers shall establish their own internal rules and regulations (the “**Internal Rules**”) to ensure (i) the protection of their employees’ rights and (ii) the performance of their employees’ obligations.

In this way, each company customizes its own rules in accordance with the Chinese laws and regulations (such document is also called “employee handbook”).

### **What should be included in the Internal Rules of a company?**

Internal Rules are important for a good management of the employees and establishment of clear disciplinary rules. Internal Rules also avoid any unreasonable control on the rights and obligations of the employees by an employer.

In China, employment contracts should then be supplemented by the company’s Internal Rules to set out the company’s policies on matters such as recruitment and training, remuneration and leave, working hour system and overtime, confidentiality in the workplace, discipline, termination of labour contracts, etc.

In addition to the abovementioned elements, the company can stipulate other elements it may consider necessary to be regulated and provided in the Internal Rules (such as the company culture).

### **Why is it important for a company to have its own Internal Rules? Can an employer dismiss an employee for misconduct without Internal Rules?**

We usually get the following question: I have an employee who did something clearly wrong, can I dismiss him/her for misconduct under the Chinese law? The answer is not that simple.

The Chinese Labour Laws and Regulations provide for limited circumstances for an employer to legally dismiss an employee for misconduct, without any severance payment and prior notice:

- termination for serious violation of the Internal Rules;
- termination for serious violation of the labour discipline;

- where the employee has committed serious dereliction of duty or has practiced favouritism for personal gains, causing a serious damage to the interests of the employer;
- where the employee has been subject to criminal liability in accordance with the law.

Without well drafted Internal Rules, it is then very difficult for a company to unilaterally dismiss an employee. Unilateral terminations without severance are most of the time challenged by employees and employers who do not have clear Internal Rules will give the employee keys to sue the company for wrongful termination. In such case, the employee will be entitled to require a compensation equal to two times the statutory severance indemnity or the reinstatement in the company and the payment of the full salary from the date of unlawful termination to the date of reinstatement.

In order to protect the employer's right of unilateral termination, the employer shall provide for, through its Internal Rules, (i) the specific labor discipline of the company, and (ii) the corresponding consequence in case of violation of those company's rules.

### **Example of the importance of the Internal Rules in case of a labour dispute with an employee**

The following recent judgment from Shanghai No. 1 Intermediate People's Court, on October 30<sup>th</sup>, 2019, is a good illustration of the fact that having no clear Internal Rules can hinder a company from dismissing an employee for a misconduct not clearly mentioned in the Internal Rules, even if this misconduct is serious.

#### **Case presentation:**

Mr. WU was hired in 2016.

Mr. WU signed the Employee Handbook of the company in 2016. This Employee Handbook specified some reasons for which the company could dismiss an employee for misconduct (including where the employee seeks private interests by the convenience of his/her position, or violates orders or instructions of supervisors, or causes loss of more than 10 000 RMB to the Company...).

In 2017, Mr. WU received by email the Approval Authorization Form specifying that before sending any quotation with an amount above 500 000 RMB to the clients, an authorization from the Management should be obtained.

Mr. WU (i) sent several quotations to the clients without requesting any authorization from his management and (ii) used the electronic company chop without authorization from the company.

The company dismissed Mr. WU for the following reasons: Mr. WU used the company's chop without authorisation, proposed abnormally high quotations to the clients without authorization, and intentionally caused the company to lose the chance of concluding the contracts with the clients. The company considered that Mr. WU's behaviour seriously violated the Internal Rules of the company and prejudiced the interests of the Company.

#### **The judge's ruling:**

Mr. WU applied for arbitration claiming the double economic compensation for illegal termination. The labour arbitration committee dismissed Mr. WU's claim. Then he filed litigation before the court. This case has gone through the first and the second instances, and the judge of the second instance considered that the dismissal was unlawful, for the following reasons:

- The company sent to all the employees in 2015 a Notice on the use of the company's chop specifying that the company's chop and the contract chop should be under the responsibility of

the financial officers, who should review all documents chopped and make record of the use of those chops. However, the company failed to prove it had served this Notice to Mr. WU, hence it should not be applicable in this case;

- regarding the Approval Authorization Form: this failed to provide for the relevant stipulations mentioning that if the employee violates this Form, the company could terminate the labour contract;
- finally, the company did not prove that it lost the business.

As a consequence, the dismissal of Mr. WU was considered as illegal because even though he did not properly follow the rules, the Internal Rules did not clearly specify that an employee could be dismissed for those specific reasons.

#### **Our recommendation in such case:**

In this specific case, the Internal Rules should have specified that the company could dismiss an employee for misconduct, without indemnity or prior notice:

- in case an employee uses the company's chop without following the company's rules regarding the use of this chop;
- Or in case an employee sends high quotation to any client without authorization of his management.

#### **What are the legal requirements for the formulation of the Internal Rules?**

##### Legality of the content

In order to be valid, Internal Rules shall be reasonable and in compliance with the law. For example, it happens that some employers specify in their Internal Rules that the employees can be dismissed without severance pay in case of late arrival for one time. But such dismissal would not be accepted by a judge, who would judge it illegal as this kind of circumstance is not reasonable.

##### Democratic procedure to be followed for the adoption of the Internal Rules

Internal Rules can only be valid if their implementation follows a process described by the law: the "democratic procedure".

According to Article 4 of the Labour Contract Law, when an employer formulates, revises or decides on rules or major matters which directly involve the vital interest of the workers, such matters shall be discussed by the employee representatives congress or all staff, who shall make proposals and give their opinions and the employer shall carry out negotiation on an equal footing with the labour union or the employee representatives before making a decision.

Moreover, companies shall bear the burden of proof that all the steps have been followed.

This procedure is essential for the Internal Rules to bind force on the employees and being opposable to them in case of dispute.

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As a conclusion, it is essential for employers in China that want to be able to properly manage their human resources to have their Internal Rules which should:

- Be specific and complete, according to their specific needs and industry;

- include the disciplinary actions for violation of the regulations or discipline, with (i) the different acts that are considered as violation of labour discipline and rules of the company and (ii) their specific sanctions (oral warning, written warning and dismissal);
- be drafted in accordance to the Chinese laws and regulations, and
- be implemented by respecting the democratic procedure.

Without such a document signed by each employee, a company will have very little flexibility to manage its human resources.

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