



## **[Company Law] Important Labor Law Issues for Foreign Companies**

### **Some context:**

- The existing Company Law of PRC was enacted in 1993, with amendments to individual articles in 1999 and 2004, a comprehensive revision in 2005, and two important amendments to issues related to the company capital system in 2013 and 2018.
- With the continuous reform of the market economy system, the number of registered companies has increased from 10.33 million in 2013 to 38 million.

### **Recent developments:**

On December 24, 2021, the Standing Committee of the National People's Congress ("NPC") published the new Company Law (Draft Revision) ("Draft Revision"). The Draft Revision contains 15 chapters and 260 articles, with substantial additions and amendments of about 70 articles on the basis of 218 articles in 13 chapters of the existing Company Law.

We note that there are several contents in the Draft Revision that are not only related to corporate governance itself, but also to labor and personnel management of enterprises, so we wrote this article for our readers' reference.

### **What are the Labor Law related issues in the Company Law (Draft Revision) that foreign companies need to be aware of?**

There are at least three points to note.

First, the expansion of the obligation to establish employee directors; second, the compensation for dismissal of directors without justifiable reasons; and third, the new provisions requiring companies to assume social responsibility.



These changes are currently in draft form and are likely to have a substantial impact on companies once these changes and their accompanying measures are implemented.

### **1. Employee Representatives on the Board of Directors**

Original Provision	Draft Revision
<p>Article 44</p> <p>The board of directors of a limited liability company invested and incorporated by two or more State-owned enterprises or two or more other State-owned investment entities shall contain employee representatives; the board of directors of other limited liability companies may contain employee representatives. Employee representatives who sit on the board of directors shall be appointed by company employees via an employee representative congress or employee congress or other forms of democratic election.</p>	<p>Article 63</p> <p>The board of directors shall consist of 3 members or more. As for a limited liability company with 300 employees or more, there shall be staff representatives of the company on the board of directors. The board of directors of any other limited liability company may consist of staff representatives of the company. The employee representatives of the company on the board of directors shall be democratically elected by the employees of the company through the staff representative assembly, the employees' meeting or other such means.</p>

#### **1) General Business Establishment Obligations**

The so-called employee directors are members of the board of directors, who are elected as representatives of the employees. The purpose of this is to strike a balance between the interests of the company, the shareholders' meeting and the employees, and to better ensure the employees' participation in the democratic management of the company.



The existing Company Law only required wholly state-owned companies to establish employee directors, therefore many foreign companies are not aware of this system. However, Article 63 of the Draft Revision stipulates that "The board of directors shall consist of 3 members or more. As for a limited liability company with 300 employees or more, there shall be staff representatives of the company on the board of directors." This change means that, in principle, foreign-invested enterprises and private enterprises are also obliged to set up employee directors.

## 2) The Establishment and Powers of Employee Directors

The Draft Revision stipulates that "The staff representatives of the company on the board of directors shall be democratically elected by the employees of the company through the staff representative assembly, the employees' meeting [Note: The employees' meeting is a body that has the same function as the staff representative assembly, in which all employees participate directly in company-related matters without being elected by the employee representatives. It is usually set up in companies with a small number of employees] or other such means." The Draft Revision does not provide further rules for the establishment of employee directors. The Opinions of the All-China Federation of Trade Unions on Further Implementing the System of Employee Directors and Employee Supervisors [The Opinion is published by the All-China Federation of Trade Unions, which is a non-governmental body, and the Opinion has no mandatory effect] stipulates that candidates for election shall be nominated by one-third of the employee representatives or at least one-tenth of the employees, or at a joint meeting of the employee representative assembly. As for the terms of reference, since there is no specific provision on the terms of reference of employee directors, it can be understood that there is no difference from ordinary directors.

## 3) How Foreign Companies Should Respond

Although employee directors are not appointed and controlled by shareholders, they have the same powers as ordinary directors and are expected to have a significant impact on the existing power



structure of the company's management.

There is no provision for the legal liability that a company may face if it has the obligation to set up employee directors, but does not do so. The existing Company Law also lacks legal liability provisions for the existing employee directorship and employee supervisory system of wholly state-owned enterprises, which makes companies reluctant to implement, and not many of them actually do. Therefore, it is worthwhile to continue to observe the future legislation of this content as well as the specific practices.

## **2. Compensation for the Dismissal of Directors**

Original Provision	Draft Revision
<p>Provisions of the Supreme People's Court on Several Issues Relating to Application of the Company Law of the People's Republic of China (V) Article 3</p> <p>Where a director, who is removed from office prior to the expiry of his/her tenure by a valid resolution passed by a shareholders' meeting or shareholders' general meeting, asserts that the removal has no legal effect, the People's Court shall not support the assertion.</p> <p>Upon removal from office, where the director files a lawsuit for a dispute between him/her and the company over compensation, the People's Court shall, pursuant to the provisions of laws, administrative regulations, the company's articles of</p>	<p>Article 66</p> <p>The shareholders' meeting may decide to remove a director. Where a director is removed before the expiration of his/her term of office without justifiable reasons, the director may claim compensation from the company.</p>



association or the contractual agreement, take into account the reason for removal from office, remaining tenure, director's remuneration etc., to determine whether compensation shall be granted and the reasonable amount of compensation.	
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The Draft Revision clarifies the right of the relevant director to claim compensation in the event of dismissal of a director without justifiable reasons.

In the past, the board of directors and management of foreign companies in China were mostly filled by foreign personnel, but nowadays it is not uncommon for Chinese employees to serve as directors. In this case, there is not only a labor relationship, but also an appointment relationship between the company and the employee. In practice, it is very controversial whether the company should be subject to strict labor law restrictions when dismissing a director (only in statutory circumstances) or whether it should be allowed to be relatively more liberal (e.g., covenant conditions or even unconditional dismissal). The Draft Revision on the compensation provides legal recognition for the removal of directors without justifiable reasons, but also adds restrictions.

In fact, the existing Provisions of the Supreme People's Court on Several Issues Relating to Application of the Company Law of the People's Republic of China (V) have clearly stipulated for the first time that the company has the power to terminate employment at will, and that compensation for termination should be judged in a comprehensive manner. Although the Draft Revision provides for compensation for unjustified termination of employment on the basis of Provisions of the Supreme People's Court on Several Issues Relating to Application of the Company Law of the People's Republic of China (V), the compensation must still be judged comprehensively in principle.

In view of the above, we believe that, at least in the case of a Chinese employee serving as a director,



it is necessary to enter into an agreement with the Chinese employee regarding his or her service as a director, which may include the remuneration of the director, the circumstances under which the remuneration may not be paid, the circumstances under which the appointment may be terminated and the compensation. Such agreements may be an important basis for handling such disputes in the future.

### **3. More Attention to the Protection of Employees' Interests**

Original Provision	Draft Revision
/	<p>Article 19</p> <p>A company engaging in business activities shall, on the basis of abiding by the obligations as prescribed in the laws and regulations, take into full consideration the interests of the interested parties such as the employees and consumers of the company, as well as the public interests such as the protection of the ecological environment, etc., and shall bear social responsibilities.</p> <p>The state encourages companies to participate in public welfare activities and release their social responsibility reports.</p>

Article 19 of the Draft Revision provides for the inclusion of corporate social responsibility in the regulation of the Company Law for the first time.

Corporate Social Responsibility reports (CSR reports) are widely used worldwide to reflect the state of corporate social responsibility for environmental and social issues, but in China, except for central government-owned enterprises and listed companies, which are increasingly starting to pay attention,



general enterprises have not yet generally formed this habit and consensus. With the promotion of the CSR reporting system, the status of employees as stakeholders is no longer only a traditional compliance issue, but it's as a part of social responsibility that will be exposed to public view and directly affect the image of enterprises.

Related to this, **the Sustainable Development Goals (SDGs)** have received increasing attention in recent years, and "decent work" is one of the 17 goals identified by the United Nations in the SDGs. Under the guidance of SDGs, the issue of employee interest protection is likely to attract more and more attention from the relevant law enforcement authorities in the Chinese government. On the other hand, the company may also be under pressure from upstream manufacturers to protect the interests of employees because of the need for corporate image building. On the contrary, the company may also make new demands on its partners in this regard.

On top of that, the protection of employees' interests will become an increasingly important issue for enterprises. For foreign-funded enterprises, which generally have higher self-imposed requirements in labor and personnel compliance management, the improvement of employee interest protection will help improve the corporate image and the competitiveness of the enterprise itself.