Client Alert

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In this issue

CSRC issues series of measures regarding employee remuneration in securities and fund industries

In recent months, the China Securities Regulatory Commission (**CSRC**), along with other government bodies and industry associations, has issued a series of new guidelines and measures regulating how companies in the securities and fund management industries may remunerate and compensate their employees.

The focus of the new measures is to prohibit short-term assessments and excessive incentives, while requiring employers to establish diversified, long-term incentive mechanisms and sound internal mechanisms for remuneration-related accountability, to prevent potentially risky conduct that could arise from unreasonable remuneration systems.

Strict prohibition of short-term assessments and excessive incentives

Prohibited short-term or excessive incentives include, among others, the following: one-sided pursuit of market rankings and short-term performance ratings; providing employees with hedging measures to weaken the link between salaries and risks; direct linkage of employees' remuneration income to the revenue from the projects that they have taken on; etc.

Establishment of long-term incentive mechanisms

The various measures and notices contain general principles about the deferred payment of salaries, for example stating that fund management companies' employment contracts and internal regulations should contain reasonable provisions concerning the scope of applicable persons, the conditions for deferred payment, the rates of payment, the number of years over which the deferred payments are made, the percentages paid out each year, etc.

In addition to remuneration payment-deferral systems, the guidelines and opinions encourage companies to explore and implement diversified, long-term incentive restraint mechanisms. For example, securities fund operators are encouraged to implement long-term incentive mechanisms such as equity incentives and employee stockholding plans, and securities companies are urged to provide enterprise annuity/commercial pension benefits to employees.

On the other hand, the CSRC and the Asset Management Association of China require fund companies to set up a mechanism that ties the interests of their staff to those of the fund unit holders. Article 12 of the Fund Management Company Performance and Remuneration Guideline states that a fund management company's officers, the responsible persons of its main business departments and the fund managers should use a certain percentage of their performance remuneration to purchase units in the publicly-offered funds managed by their companies or themselves, and that they should observe the time-related restrictions applicable to fund investments by fund staff. The article also contains detailed provisions on the types of funds in which units are to be purchased and the percentage of the performance remuneration to be used for such purchases.

Sound internal mechanisms for remuneration-related accountability

The new rules require securities fund operators to establish an internal mechanism for remuneration-related accountability, such as having policies on discontinuing, recovering and deducting bonuses, allowances and other such remuneration. Companies may halt payment of the unpaid portion of the remuneration of staff responsible for the companies' violations of laws or regulations or for operating risks faced by the companies. They may also require such staff to return relevant bonuses received for the year in which the misconduct occurred, discontinue the payment of long-term incentives to them or take other action. The Fund Management Company Performance and Remuneration Guideline specifies that the accountability mechanism should also apply to ex-employees.

Party organizations in fund management companies

Measures directed at fund management companies state that they should provide conditions necessary for the Party organization's activities. While these measures received some attention in the media, they do not actually go beyond what is already stated in the Company Law. What is particularly interesting is that the CSRC has now decided to specifically include them in regulatory requirements for fund management companies.

A separate notice directed at securities companies states that they should fully leverage the "leading function of Party-building in the management of operational integrity." This provision does not specify how the Party organization should manage operational integrity, though the inclusion of this provision does further show the CSRC's renewed focus on the role of Party organizations within companies in this industry.

Key takeaways:

The guidelines and measures issued by the CSRC this year are similar in their focus to the guidelines respectively issued by the China Banking Regulatory Commission and the China Insurance Regulatory Commission (which have since merged) over a decade ago, though on the whole, the CSRC's recent measures are less detailed than the earlier guidelines directed at banks and insurance companies. Companies in the securities and fund management industries should still abide by the general principles laid out in the various applicable measures and develop long-term incentive systems, improve their internal accountability systems, establish reasonable remuneration structures and ensure that their remuneration payments are compliant.

Amended Shanghai Labor Union Regulations provide some additional protections for employees

The newly revised Shanghai Labor Union Regulations ("**Regulations**") came into effect on June 1, 2022. Some of the major changes are summarized below:

- **Scope of union's participation rights expanded:** The revised Regulations expand the scope of types of matters that involve the immediate rights and interests of employees, and which therefore the union should be consulted on, from "wages, benefits, labor safety and hygiene, social insurance, etc." to "labor compensation, welfare, production safety, labor protection, working hours, rest, leave, protection of female employees, social insurance, etc." Additionally, the Regulations specify that if the union requests that the employer review its decision to terminate an employee's contract, the employer needs to give the union written notice of its decision upon review and attach the relevant documentation. The union must participate in the investigation and handling of accidents relating to production safety. If the Regulations are violated, the Federation of Trade Unions at the municipal and district levels can supervise and urge rectification by means such as issuing a written labor union

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opinion on the supervision and rectification of a labor law issue. The relevant authorities should record the violations in the social credit information service platform and take disciplinary action as a warning.

- **Promoting democratic management:** The Regulations make clear that an employee representative council (**ERC**) is the basic form of democratic management in a company, and companies should establish an ERC in accordance with the law. Further, when companies study major issues concerning their operations, management and development, they should listen to the opinions of the labor union. When they hold meetings to discuss issues involving the immediate interests of their employees, union representatives must participate. In general, female union representatives should participate in the discussion of matters involving the protection of female employees.
- **Protecting gig workers:** As time passes, unions should adapt to developments in the form of organization of enterprises, workforce structures, employment relationships, modes of employment, etc. They should protect all types of workers' rights to join and organize labor unions. The Regulations provide a clear basis for the establishment and joining of labor unions by gig workers.

Key takeaways:

The recent round of revisions to the Regulations place emphasis on the democratic management of companies, though the revisions are stated in the form of general principles and provide little concrete guidance. The added provisions regarding gig workers are in line with recent national guidance over the past couple of years focusing on the rights and interests of gig workers. Companies with a labor union should pay particular attention to the obligation to notify the union of their unilateral termination of employment contracts.

Guangzhou court rejects company's claim of copyright in work created by an employee

The Guangzhou Internet Court recently concluded a copyright dispute case between an employee and his employer arising when the employee took on a side job and made a video by utilizing the resources of the employer. Based on the intellectual property ownership clause of its employment contract, the employing entity claimed that it owned the copyright in the work created by the employee in his "side job", but the claim was rejected by the court.

The employment contract between the employer, a technology company ("**Plaintiff**"), and the employee provided that "the property rights in software developed as part of the Employee's occupation, occupational works, and new products completed, or software, products, drawings, drafts, books, and other forms of creation researched and developed, in the Employee's spare time using funds, technology, information or other conditions provided by the Company shall vest in the Company, and the Employee shall have no right to take possession of the same or to provide the same to third parties."

Against this background, the person in charge of the Plaintiff's automotive department privately established a wholly individually owned company providing third parties with short video-shooting services and, without authorization, arranged for staff of the Plaintiff to shoot videos using the Plaintiff's company resources. The videos were then disseminated, for profit-seeking purposes, through a TikTok account of a third party to whom he privately provided services. Upon discovering the above, the Plaintiff promptly sued the employee, his wholly-owned company and the third party to whom he provided services, demanding that they cease the infringement and compensate for the loss and claiming that it owned the copyright in the works shot by the employee in his side job.

During the trial, the court determined that the intellectual property ownership clause of the employment contract was a standard boilerplate clause. It held that the expressions "other conditions" and "other such forms of creation" mentioned in the clause should be interpreted as not going beyond the scope of the specific items preceding them, i.e., as having been created for the Plaintiff, and that the expressions did not cover the shooting of videos for third parties.

The court pointed out in particular that in the event of a dispute between contracting parties over the interpretation of a standard clause, the clause should be interpreted in a way that does not favor the party that provided it. In other words, in circumstances not provided for or not fully provided for in the contract, the contract should not be interpreted by means of inference or expansion; rather, it should be interpreted as narrowly as possible.

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Key takeaways:

In the course of litigation, any clause of an employment contract could be held by the court to be a standard clause drafted in advance by the employer for ease of repeated use, and thus be interpreted by the court in a way that does not favor the employer. Therefore, when employers draft their employment contracts and company regulations, the provisions on the "taking on of private jobs" by employees and other frequent risks should be worded in a way that offers the widest coverage possible and try to be specifically worded to the extent reasonably feasible.

Supreme People's Court highlights case regarding invalid non-compete term

On July 4, 2022, the Supreme People's Court issued seven guiding cases in the employment law area to provide guidance to the lower courts. One of the cases, decided in Beijing, makes clear that part of a non-compete clause should be held to be invalid if the employer disclaims its legal liability or denies the worker their rights, even if the terms were voluntarily agreed upon.

In this case, the employer and the employee signed a non-compete agreement, which provided that the period of the arbitration and litigation procedures in the event of any dispute should not be considered part of the non-compete period stipulated in the agreement; in other words, the term during which the employee would be bound by the non-compete restriction would include not only the specific term agreed by the parties during which the employee receives non-compete compensation, but also any period of arbitration or litigation in the event of a dispute.

The law requires the employer and employee to stipulate a non-compete term of no more than two years post-termination. The legislative purpose of the statutory restriction is to make non-compete clauses specific and unambiguous. Mentioning the period of arbitration and litigation procedures in the stipulation concerning the length of the non-compete period goes against such legislative purpose. Furthermore, a considerable number of employment dispute cases undergo arbitration and two instances of litigation. If a dispute arises between the employer and the employee, the above-mentioned stipulation would extend the duration of the non-compete period for an unforeseeable but fairly long period of time, even exceeding two years.

The stipulation also unfairly restricts the employee's legal remedies to a certain extent, as the employee would have to choose between initiating a claim to protect their interests and potentially extending the term of their own non-compete restriction.

The court therefore held that the stipulation in the non-compete agreement on the non-compete period being extended by the period of the arbitration and litigation procedures was invalid. However, the invalid part of a contract does not affect the validity of the remaining terms, so the non-compete agreement itself and its other stipulations remained valid.

Key takeaways:

Although the law permits employers to agree on non-complete obligations with their employees, it also imposes mandatory requirements on the content of the stipulated obligations by expressly restricting the scope of employees and the period of time that are subject to the non-compete obligations. Failure to abide by those statutory restrictions will render the stipulations invalid. This requirement prevents employers from causing excessive harm to their employees' freedom of job choice by abusing the non-compete system.

Supreme People's Court issues guiding case highlighting importance of termination notices

Another one of the seven guiding cases mentioned above, decided in Jiangsu Province, makes clear that the facts and termination grounds stated in a unilateral notice of termination for a breach of disciplinary rules could be crucial when deciding whether the termination is lawful.

The employee in question had committed multiple disciplinary offenses, e.g., being absent without leave, failing to hand over business payments in a timely manner, failing to wear work clothes, clocking in or out for others, posting messages on the entity's public platform that were abusive of the company's officers, etc. The termination notice issued by the company to the employee stated that, based on the company's regulations, it had been decided to terminate his employment summarily due to absence without leave for at least three days. Being dissatisfied with the termination decision, the employee sued the company for unlawful dismissal.

The court held as follows:

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- Since the company terminated the employment contract due to unexcused absence, it bore the burden of proof to prove such absence. However, as the evidence provided by the company was unclear (the attendance sheet submitted by the company was not recognized by the employee because it had not been signed by him), the factual basis for the details of the absence was insufficient. Therefore, the employment contract had been terminated illegally.
- During the hearing, the company mentioned other disciplinary offenses by the employee, such as failure to hand over business payments in a timely manner, failure to wear work clothes, etc. The company argued these offenses also constituted material violations of company rules, and still entitled the company to terminate the employment contract. However, the company's termination notice had not mentioned those offenses as grounds for termination, and the court could not go beyond the content and extent of the termination letter when deciding on the legality of the termination. Therefore, the allegations raised by the company during the litigation were not supported.

Key takeaways:

This case shows that companies need to be very careful about the content of the termination notice they issue to employees when terminating their employment, particularly for misconduct.

One option for companies is to compile a list of all provable disciplinary offenses and put them in the unilateral termination notice as grounds for termination due to material breach of disciplinary rules. If any of the facts of breach are not admitted due to lack of evidence, the other proven facts of breach can serve as the basis for termination. In addition, language should be included stating that the employee's breaches of disciplinary rules include, but are not limited to, those listed in the unilateral termination notice. By doing so, the company may still be able, during arbitration or litigation, to supplement its case with the facts of breaches that were not specified in the unilateral termination notice.

As an alternative to listing the specific facts of the disciplinary offenses, the unilateral termination notice could state concisely that the employee's disciplinary offenses constitute a material breach of its regulations. This would minimize the restrictions faced by the company in using the facts of all of the employee's provable disciplinary offenses as a basis for termination of the employee's contract.

Supreme People's Court provides guidance on bonus disputes involving departing employees

Among the seven guiding cases mentioned above, the Supreme People's Court also highlighted two cases providing guidance on how to handle disputes arising from the non-payment of bonuses to departing employees.

In one Nanjing case, a certain urban development company had formulated an internal bonus policy providing that if an employee netted a development project for the company, the company would grant a bonus in proportion to the anticipated profit from the project after overall consideration of factors, such as the project's size and profit value. The employee landed the company six projects during his employment, but no project bonuses were paid. Upon his departure, the employee claimed payment of bonuses totaling more than RMB 1 million. The company refused to make the payment, citing reasons such as the fact that the bonuses had not been approved, the employee had committed serious dereliction of duty, the projects were loss-making, etc.

The dispute went to arbitration and two levels of court hearing. Ultimately, the appeals court upheld the employee's claim. The court held that the employee had satisfied the relevant conditions under the company's bonus policy. If the company did not agree to pay the bonuses, it has the burden to explain its reasons and provide relevant evidence. The grounds for its refusal were untenable, because the company had failed to provide relevant evidence and had not proved the so-called dereliction of duty by the employee or the loss-making status of the projects. Furthermore, the court held that the company had an obligation to conduct a substantive examination of bonus applications made by eligible employees. If the company refused to perform its examination and approval obligations without a legitimate reason and the employee was able to show that the conditions for payment of the bonus had been met, the company should pay the bonus as provided for in the regulations.

In a separate case decided in Shanghai, a company's employee handbook expressly stated that the condition for payment of a year-end bonus was that the employee concerned remained employed on the date of payment. Each year's bonus was paid around March of the year after the bonus period. The employee in question was dismissed on December 29, 2017, due to a major change in objective circumstances. The employee subsequently applied for arbitration, demanding payment of the 2017 bonus and reinstatement of employment.

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The dispute went to arbitration and two instances of litigation. Ultimately, the appeals court supported the employee's demand for payment of the bonus. It held that if an employee who left before payment of the year-end bonus claimed payment thereof, the employer should consider the reason for the employee's departure, the time of departure, the work performance, the importance of their contributions to the company, etc. If the company's policy said that those who leave before the payment date were ineligible for the year-end bonus, but the contract's termination was not due to the employee's negligence or due to their voluntary resignation, and the employee had completed the year's work assignments, then the company should pay the bonus unless it could prove that the employee's work results and performance did not satisfy the criteria for payment of the bonus.

Key takeaways:

The above-mentioned two cases show that in their trial of bonus-related cases, the courts do not solely look at the specific rules and policies of the employer. They also consider whether the rules and policies are reasonable and examine the specific implementation and practice of the company's bonus policy. Therefore, companies should make their bonus rules and policies clearer and more detailed in terms of addressing different potential circumstances. For example, the payment criteria should differentiate between the employee's specific circumstances (e.g., the reason for their departure), which may make the rules and policies seem more reasonable.

Hangzhou court rules company cannot force employees to set off quarantine period against annual leave entitlement

The Xiaoshan District Court in Hangzhou Municipality recently held that the quarantine leave taken during the pandemic may not be set off against an employee's annual leave entitlement. In March 2022, the said court supported an employee's claim of illegal dismissal and ordered her employer to pay her a total of more than RMB 90,000 in damages for illegal termination of her employment contract, salary in lieu of unused annual leave in 2019 and 2020, and travel allowance. While the employee was being quarantined at home due to the COVID-19 pandemic, she received a notice that her department was being shut down and she received a contract termination notice from her company. The company, in addition to arguing the termination was lawful, argued that the resumption of work had been delayed by the pandemic and that the leave taken during the delay could first be set off against the employee's unused days of annual leave.

In its judgment, the court held that leave during the pandemic may not be set off against annual leave. The employer had not reached agreement with the employee on the offsetting of leave during the pandemic against her annual leave entitlement. Furthermore, it had failed to notify the employee. The employer should pay the compensation in full for the unused days of annual leave.

Key takeaways:

The above-mentioned court judgment signals that if a company wishes to require its employees to set off their home quarantine period during the pandemic against their annual leave, it would be safest to discuss the matter with the employees and obtain their consent beforehand. The Regulations on Paid Annual Leave of Employees states that while companies should consider employee wishes when arranging annual leave, ultimately companies may arrange annual leave for their employees in a coordinated manner based on their overall business situation. While this implies that companies generally have ultimate decision-making power regarding annual leave, in the special situation where an employee is under a mandatory quarantine order, the government's main policy goal is to ensure such quarantine has no negative impact on employees' rights and interests, in order to ensure full compliance with quarantine policy.

Failure to follow democratic consultation procedure leads to unlawful dismissal ruling

A recent unlawful dismissal case in the Chongqing Second Intermediate People's Court serves as a reminder that it is important for companies to follow the legally-required democratic consultation procedure and publication obligation when they formulate HR-related company rules and policies ("**Regulations**").

The employee in this case was a store sales clerk who was required by her employer to take a picture in the store when arriving for work and leaving for the day, and to upload the pictures to the office. The company monitored the employee's attendance online, based on the timestamps and locations of the uploaded pictures. The company determined that the employee submitted false

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attendance records, because the sign-in addresses she recorded did not match the GPS addresses and because the uploaded pictures were suspected of having been doctored. The company gave the employee notice of termination due to her submission of false attendance records in violation of the employee handbook, which specified that this violation was punishable by dismissal. After the employee challenged this, the arbitration ruling, the judgment at first instance court and the appeal judgment all held the dismissal to be unlawful.

The employee handbook submitted by the company indeed contained relevant provisions, such as that the submission of false attendance records was punishable by dismissal. Furthermore, the union had concurred with the decision to dismiss the employee. However, the termination was still ruled unlawful because of a defect in how the employee handbook was adopted, as per the below:

- The court judgment stated that employers should follow the democratic consultation procedure when formulating their rules and policies having a direct impact on employees' immediate interests, and such rules and policies should be made known to the employees.
- An employer can be determined to have made its rules and policies known to the employees if it can prove that the employees know or should know the content thereof, e.g., evidence that: notices were put up, training sessions were organized, employee handbooks were distributed, the rules and policies were published on an online platform, etc. In the absence of such evidence, the employer will be deemed not to have made the rules and policies known to its employees.
- When amending their rules and policies, employers should use effective means to make the changes known to their employees. In this case, the company failed to prove that it had publicized the new version of its employee handbook or that it informed the employees of the revised employee handbook, which stated that the submission of false attendance records is punishable by dismissal. Even if the employee had submitted false attendance records, as was alleged by the company, it was unlawful for the company to dismiss her based on company rules that had not been made known to the employees.

Key takeaways:

This case serves as a reminder that companies need to follow the legally-required democratic consultation procedure (or at the very least, effectively publicize the rules to all employees and fully document this publicizing) when formulating their HR-related company rules and policies. This legal requirement is also applicable to revisions to, and updates of, company rules and policies. If this is not done, there is a higher likelihood that the court would support the employee and determine dismissal of the employee pursuant to such company policy to be unlawful, even if the underlying misconduct is proven.

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