



## Settlement of Termination Payments: Are they Enforceable?

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### Introduction

It is common practice for an employee and employer to attempt to negotiate the monetary amount that the employer is required to pay the employee upon termination of employment. Any agreement in such circumstances will generally involve an employer paying an amount equivalent to its potential legal liability or lower. However, a question arises as to whether, under China's Labour Contract Law, such an agreement is enforceable if an employee ultimately reneges on its agreement and takes the dispute to labour arbitration. The notion of free will and fair bargaining underpin Chinese contract law and the Chinese legal system in general. Accordingly, there may be such occasions where such an agreement could be struck down by the court. This article discusses this issue and provides practical solutions to avoid having an unenforceable agreement.

### Avoiding Labour Arbitration.

We generally advise employers that it is in their interest to avoid labour arbitration as, in most cases, it favors the interests of employees. Further, in labour arbitration and litigation in China there is little possibility of recovering your legal costs and, accordingly, even if you are ultimately successful, there is a strong likelihood that you will incur legal expenses greater than the potential liability. For these reasons, many employers make every effort to settle matters with employees. The assumption is that in coming to an agreement with an employee, arbitration will be avoided. The question is whether this assumption is always correct. Article 5 of the Law of the People's Republic of China on Labor Dispute Mediation and Arbitration states that labour arbitration is available "where a labor dispute arises, if a party does not desire a consultation, the parties fail to settle the dispute through consultation, or a party does not execute a reached settlement agreement". It seems, on the face of the matter, that where there is an agreement between the parties, there is no jurisdiction for the dispute to go to labour arbitration. However, from our experience, such a strict interpretation is not correct.

### When an Agreement will not be Enforced

If an employee reaches an agreement with an employer regarding the termination of the labor contract and the economic compensation is far from the statutory standards, generally the agreement shall be deemed as invalid because it exempts the employer from statutory liability

and extinguishes the rights of the employee. The concepts of free-will and fair bargaining are critical principles underpinning Chinese Contract Law, particularly in the employment context. Article 4 of the Contract Law provides that '[t]he parties have the right to lawfully enter into a contract of their own free will in accordance with the law, and no unit or individual may illegally interfere therewith.' Further, Article 3 of the Labour Contract Law provides that '[t]he principle of lawfulness, fairness, equality, free will, negotiation for agreement and good faith shall be observed in the formation of a labor contract.' Whilst a settlement agreement in relation to economic compensation payable to an employee is not technically a "labour contract", the matters outlined in Article 3 reflect common principles. Accordingly, where the agreed amount is well below the legal entitlement it will be difficult for the employer to show that the principles of fair-bargaining existed. In such circumstances, after an employee obtains economic compensation according to the agreement, if the employee applies for arbitration or files a suit to ask the employer pay the balance of the legal entitlement, the application shall be supported.

### **When an Agreement will be Enforced**

From the above, it is clear that the critical issue is whether there is fair-bargaining between the parties. As such, if the agreement stipulates the calculation methods and standards of economic compensation and the employee acknowledges that the agreed economic compensation is far from statutory standards, it shall be deemed that the employee has disposed of his or her rights, and any application to alter the terms of the agreement would be rejected. Further, if after an employee obtains economic compensation in accordance with an agreement with an employer, he or she applies for arbitration or files a suit beyond the *statutory limitation period* (it should be noted that the statutory limitation period is 1 year from the date of termination) for the balance of the employer's legal liability, the employees rights shall be extinguished.

### **Lehman, Lee and Xu's Recommendation**

It is our strong recommendation that, in reaching an agreement on the terms of termination with an employee, that an employer advise the employee of the relevant provisions regarding economic compensation and the amounts of economic compensation obtainable from the employer according to the law. Best practice would dictate that such information be disclosed and acknowledged in the agreement itself.

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