Why representative office placement does not work

A representative office using temporary workers is challenging and more burdensome than direct employment, as agencies in practice release all responsibility after workers have been placed. Legal reforms have not clarified the situation, which means it may be time for investors to switch to a WFOE

There were 49,223 foreign representative offices in the PRC at end March 2013, according to statistics from the Bureau for Foreign Investment Registration of the State Administration for Industry and Commerce in Beijing. If you ask any chief representative about the placement of their Chinese workers, they will tell you it is a mess. They will also say that placement costs them a great deal of time and money, and that agencies are useless. Despite this, the institution of placement has been around for over 30 years (see figure 1 for an overview of placement in China). The revised *PRC Employment Contract Law* (中华人民共和国劳动合同法), which will enter into force this year, gives little hope for changing this situation.

Defining placement

Placement is a contractual relationship between three parties: the worker, the placement agent and the user of the placed worker. The worker is employed by an agent, who enters into a contract for the provision of labour service with the user and then places the worker with the user, where the worker will perform the work. This creates a triangular relationship; the first side rests on a contract of employment between the worker and the agent, and the second side on a contract of service between the agent and the user. The legal qualification of the third side, between the worker and the user, is ambiguous.

For clarity, in this article the parties to placement are referred to as a "placed worker" or "worker", "placement agent" or "agent" or "agency", and "user of placed worker" or "user". However, the term "placed worker" is not used in English, nor is it a Western legal term or concept. The term "placed worker" is commonly translated as "temp worker", because this is the natural English term. The term "temp worker" neither refers to part-time workers nor to temporary workers, as these are different concepts altogether, which along with voluntary placement workers, will not be discussed. The term "employment" or any of its derivatives exclusively relates to an employment relationship, for example, the relationship between the placed worker and their placement agent, not the placed worker and the service recipient, because the latter does not employ the worker; it receives or uses their services.

Legal provisions

The 2008 Employment Contract Law contains 13 provisions on placement. This Law effectively replaced the *PRC Labour Law* (中华人民共和国劳动法), but did not formally repeal it. However, the Labour Law did not specifically address placement. The 2008 Employment Contract Law has been revised and the revision will become effective on July 1 this year. While the revisions mainly consider placement, they have failed to address issues affecting placed workers of representative offices.

There are many other provisions that indirectly apply to placement. Other provisions in the 2008 Employment Contract Law primarily govern the worker-user relationship, but what is sometimes overlooked is the user-agent relationship. This relationship is basically a mandate and as such subject to Part Twenty-One, Article 396 of the *PRC Contract Law* (中华人民共和国合同法). Even though its name makes it clear, it is often forgotten that the representative office is a representative of the principal company. Any relationship with third parties falls under Articles 48 to 50 of the Contract Law on representation or agency. In addition, if the worker-user relationship is of a contractual nature, it shall also be gauged against the Contract Law. Figure 2 outlines the contractual structure of placement.

Parties and personality

Placement is a multipartite relationship involving no fewer than four parties, which is double that of direct employment. Confusion is caused because most of the time these parties do not know who is supposed to do what. The four parties are the representative office and its principal, the agent and the worker. With so many parties involved in placement, the margin for error increases while the ease of enforcing the law decreases, and one party can simply blame the other.

Mandatory placement only applies to representative offices, but they do not enjoy a legal personality. They only represent their principal, the foreign company. This is generally ignored by most of the parties at stake and more so by the agencies and the Chinese government, which often treat representative offices as if they enjoyed a legal personality, or not, depending on their mood. While the representative office is the beneficiary of the placed worker, the only employer is the foreign company abroad, merely represented by the former. Ignoring it entails the risks related to representation without power. This is one of the reasons placement is a mess, because agencies and workers do not comprehend this notion.

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John Liebeskind, Global Law Offices

Figure 1: Looking back – foreign investors and agencies

Foreign investors were authorised to establish themselves in China around 1980. Establishment came in two forms: a Sino-foreign joint venture (JV) or a foreign representative office. For JVs, Chinese workers are directly hired with labour procedures typically handled by the Chinese partner. However, representative offices cannot hire Chinese workers directly. They can only do so indirectly through an agent. Initially, Beijing Foreign Enterprise Human Resources Service (FESCO) was the only agency. Representative offices created a situation that was legally qualified as placement and has persisted to date. A third form of FIE, the wholly foreign-owned enterprise (WFOE), which gained traction in 2000, allows foreign investors to hire Chinese workers directly.

Figure 2: Contractual structure of placement

Even though the 2008 Employment Law lacks clarity over contractual structure, placement rests on four contractual documents:

1. Employment Contract: the worker and the agent are bound by an employment contract (Article 58).
2. Service Contract: the user and the agent are typically bound by a service contract, generally called an agreement for the provision of labour service. This is a framework agreement that contains general conditions of service. It generally provides for the rights and obligations between the user and the agent, but contains no specifics on each individual placement.
3. Placement Agreement: in addition to the service contract, for each individual placement, the user and the agent must enter into a placement agreement (Article 59). Unlike the service contract, which is not specifically mentioned by the Law, but is common practice with all four major agencies, placement agreements are rarely signed.
4. Worker-User Relationship: the worker and the user may enter into an accessory arrangement, of a semi-contractual nature, which is generally known as internal rules, staff regulations, code of conduct or complementary provisions. While the law does not explicitly mention this arrangement, the 2008 Employment Contract Law alludes to it in at least two provisions (Article 60 and Article 62).

Putting theory into practice

The legal framework of placement, although complex and often imprecise, is sound. In contrast, the practice of placement, especially for representative offices, has numerous issues. It has actually become a burden for many representative offices. The cause of this burden is due to misunderstandings about the very nature of the institution. This may be because of its inherent legal complexity, of vested interests, of sheer incompetence, of fatalism, or of any combination of these. Three such misunderstandings can be singled out. The first consists in mixing up who is the employer; the second in overlooking the economic relationship underlying the service contract; the third bears on the legal nature of the user-worker relationship.

Who is the Employer?

Article 58 of the 2008 Employment Law states: "A placement agency is an employer as defined herein and shall perform the obligations of an employer towards workers." However, experience proves that most users, workers and, which is more worrying, even agents, i.e., their account managers in charge of day-to-day business, believe that the user, not (or not only) the agent is the employer. This means users sign employment contracts with their workers without knowing that the latter already entered into one with the agency. Users believe that the Employment Law applies to them directly, as if they were employers. Workers raise contractual pretences against users, not understanding that the agency is their primary contractual counterpart. Major agencies serving thousands of representative offices issue standard service contracts which, after correctly declaring that the agent "shall legally enter into the Labour Contract or the Labour Agreement with the employee dispatched to [the user's] work place by [the agency]", absurdly state in the next article that "an employment relationship shall exist between [the user] and the aforesaid staff dispatched by [the agency]. They may conclude an independent *Employment Agreement*" (their emphasis).

This is wrong. The situation is even worse when the representative office, rather than its principal, has been mistaken for the worker's and the agent's contractual counterpart. It blurs legal security and inflates the representative office's legal costs, which it often has to bear alone.

How agencies avoid their obligations

The second misunderstanding consists in overlooking the economic relationship underlying the service contract. From an economic and ideal point of view, the agent transfers to the user his employer's rights towards the worker, while retaining the corresponding obligations. In exchange, the user pays the agent a fee. The parties' economic interests are balanced: the user's right to enjoy the worker's work is balanced by the obligation to pay a fee to the agent, while the latter's right to receive that fee is balanced by his employer's obligations.

However, in the context of representative office placement in China, this simple truth seems to have been completely forgotten. Under the pretext that placement is mandatory, representative offices both pay fees and effectively shoulder most of the employer's obligations, while agents cash their dues and shrug about anything else. While agencies typically offer payroll services for taxes and social security, reportedly these are often so deficient that representative offices routinely take them over, or entrust an accounting firm in the agencies' stead. Many representative offices complain that whenever they had an issue with a worker, the agent systematically replied that it was none of their business.

Termination

This imbalance climaxes whenever the representative office contemplates the placement's early termination. According to the 2008 Employment Law, the user may terminate the placement (and the agent may terminate the employment) whenever there is a cause, such as those for immediate termination of the employment (Article 39), or for a 30-days notice cause, i.e., in case of long term illness, or in case of incompetence (Article 40, Sections 1 and 2). The last case is both the most frequently invoked and the most challenging. Thus termination will be legal only if the worker is incompetent "and after undergoing training or an adjustment of his/her position he/she remains incompetent". In practice, it is often effectively acting as an iron bowl. In such cases, agents are frequently reported to offer representative offices only two bad choices: keeping an incompetent worker for an indefinite period of time, or paying a double severance for illegal termination as prescribed by Articles 47 and 87. Meanwhile, the agent will wash his hands of it, except when it comes to severance. The inherent legal complexity of this

monstrous, multipartite situation turns out to be disproportionately costly for the representative office. Practically, when the worker is replaced with another user before severance is used up, the fate of the unused portion turns out to be a non-issue.

Worker-user relationship

The relationship between the worker and the user is another area of concern. Legally, the relationship barely exists. When the worker does his job, he is merely performing the service that the user purchased from the agent. There is an employment relationship between the worker and the agent, and a service one between the latter and the user, but only a de facto one between the worker and the user. Yet their relationship cannot be less than a semi-contractual one, by which the worker and the user agreed, expressly or tacitly, to be mutually debtor and creditor of certain rights and obligations.

Nevertheless this relationship can only be ancillary to the employment and to the placement service, for which it cannot be a substitute and with which it cannot compete. As such it should only affect secondary points. Mostly, it cannot create an employment relationship parallel to that between the worker and the agent. The fact that most, if not all, of the major agencies tolerate, or even encourage, parallel employment contracts says enough about the confusion prevailing among thousands of representative offices across the country. It not only adds to the imbalance denounced above by stealthily shifting the agent's duties of employer on the user's shoulders, but also creates a maze of contradictory rules, which translate in turn into administrative and legal costs disproportionate with those of small operations like representative offices.

Placement is a multipartite relationship involving no fewer than four parties, which is double that of direct employment

Revision of the Employment Contract Law

Sadly, the revision of the Employment Law, which will enter into force on July 1 this year, does nothing to improve the situation and even makes things worse. The revision primarily deals with the boom in part-time work and the abuses brought about. Figure 3 outlines the key agencies used for placement. There are also minor players, the majority of which are reportedly unlicensed. Unlicensed players have been growing because of the increasing trend to use part-time workers, escaping the burden of regular employment. This was one of the main reasons the Employment Contract Law was revised.

The changes include unlicensed agencies and salary dumping (see new Articles 57 and 63) as well as oral contracts (Article 69, Section 1), no-notice, no-severance termination (Article 71) and chain contracts (Article 72, Section 2). The new provisions do nothing to address the issues outlined in this article and are unlikely to prove effective anyway, if one considers that the fines have only been raised to Rmb50,000 ($8,115) from Rmb5,000 (Article 92) – not enough to act as a deterrent.

Figure 3: Placement agencies

While FESCO (北京外企人力资源服务有限公司) used to enjoy a monopoly until some years ago, the Chinese government has allowed competition and ever since there are three major players: FESCO, which remains the largest, CIIC (China International Intellectech) (中国国际技术智力合作公司) and Star (China Star) (中国四达国际经济技术合作公司) In addition, the DPSC (Beijing Personnel Service Corporation for Diplomatic Missions) (北京外交人员人事服务公司) is the mandatory agency for diplomatic representations and NGOs.

Article 66 restricts placement to temporary, ancillary or substitute positions, whereby they are respectively defined as lasting for fewer than six months, non-main positions providing services for main business positions and temporary replacement. Moreover, placed workers may not exceed a certain percentage of the total workforce. These definitions evidently clash with that of a representative office chief, where as the quota of placed workers conflicts with that aiming at the opposite, i.e., restricting the number of non-placed, foreign deputy chief reps. It remains to be seen if the forthcoming implementing regulations will address these contradictions.

While there are many more issues that need to be addressed, there are some conclusions to draw from what has been discussed. Placement in representative offices is a broken system. The original motives have disappeared and been replaced by illegitimate ones. The revised Employment Contract Law suggests that representative offices have no place on the legislator's agenda. This strengthens rumours that representative offices are to be phased out. It may be time to be pragmatic and to shift to a WFOE. Savings on representative offices' hidden, but substantial costs will arguably compensate the additional costs. For chief representatives who do not want to switch, it is recommended they build up a sound awareness of placement's legal structure. They should firmly reject standard service contracts, forcefully negotiate new contracts, insist on strict performance and never hesitate to walk away when the agent relents. Chief representatives should remind agents that they want value for money and to be better off, not worse, by using their services.

John Liebeskind, Global Law Offices, Beijing

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RELATED LEGISLATION:

- *PRC Employment Contract Law (Revised)* (中华人民共和国劳动合同法) (修订)
- *PRC Employment Contract Law* (中华人民共和国劳动合同法)
- *PRC Labour Law* (中华人民共和国劳动法)