Termination of Employment Relationships in Japan (Part II):

Dismissal and Refusal to Renew a Fixed-term Contract

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This time, we look at dismissals and refusal to renew fixed-term employment contracts.*

I. Dismissal

Dismissal is an employer's manifestation to an employee of their intention to terminate the employment contract. Unlike resignation or termination of an employment contract by mutual consent, the employment contract relationship may be dissolved in the case of dismissal, as a result of the employer unilaterally manifesting their intention to end the contract. Provisions to protect employees are therefore set out in the Labor Standards Act (LSA) and Labor Contracts Act (LCA).

A. General

The Labor Standards Act prohibits dismissals in the periods of absence from work due to injuries or illnesses suffered in the course of employment nor within 30 days thereafter, and in the periods of absence from work by women before and after childbirth nor within 30 days thereafter (Article 19). Furthermore, statutes prohibits discriminatory or retaliatory dismissals on specific grounds such as gender or union activities (such statutes includes LSA Article 3 and 104, Paragraph 2; the Act on Equal Employment Opportunity between Men and Women, Article 6 (Clause 4) and 9; the Act on Care Leave for Child or Other Family Members, Article 10 and 16; and the Labor Union Act, Article 7).

Dismissals in general, such as dismissals on the grounds of lack of ability or incapacity to perform work duties, have essentially been regulated by the case law called the "abuse of the right to dismiss" theory (*Kaiko-ken ranyō hōri*). This theory, which is for screening and restricting employers' exercise of the right to dismiss employee (manifestation of the intention to dismiss employee), was established by the Supreme Court rulings in the mid-1970s (The *Nihon Shokuen Seizo Co.* case, Supreme Court, Second Petty Bench [Apr. 25, 1975] 29 *Minshu* 456; and the *Kochi Hoso Co.* case, Supreme Court, Second Petty Bench [Jan. 31, 1977] 268 *Rohan* 17).

As formulated by the Supreme Court, the "abuse of the right to dismiss" theory states that in the event that a dismissal lacks objectively reasonable grounds and is not considered to be appropriate in general societal terms, it will be considered an abuse of the employer's right to dismiss employee and therefore null and void (ruling on the *Nihon Shokuen Seizo Co.* case, 1975). The Supreme Court also set out the specific standard for the judgement used in the theory by declaring that employers cannot always dismiss employee even in the event that there are normal grounds for a dismissal, and when a dismissal is notably unreasonable in the specific circumstances concerned and cannot be considered appropriate in general societal terms, said manifestation of the intention to dismiss employee shall be deemed to be an abuse of the right of dismissal and therefore null and void (The *Kochi Hoso Co.* case, 1977).

By the 2003 Revision of the Labor Standards Act, this unwritten case law was incorporated into the Act as the explicit provision (Article 18-2). This

step was taken because the theory was not statutory provision and therefore lacked clear social bearing, despite having served a key role in the regulation of dismissals in Japan (securing employment and ensuring long-term continuous employment). It was also considered necessary to put the theory in the statutory provision in order to put a stop to irresponsible dismissals in recession periods. The theory is now, as it is, moved into the Labor Contracts Act enacted in 2007 and prescribes that "if a dismissal lacks objectively reasonable grounds and is not considered to be appropriate in general societal terms, it is treated as an abuse of the rights and is invalid" (Article 16).

Let us turn our eyes to policy discussion in Japan with this theory. The current Japanese government is trying to change the legal rule of dismissal theory mentioned above, because it is difficult to anticipate final judgement in the court through this theory for the parties involved. So, the government is considering for developing a system of handling dismissal disputes such that clear anticipations can be made regarding the result of disputes, and for introducing monetary resolution system on dismissal disputes. There is some possibility that such future developments might undermine the socially valuable and important function that the "abuse of the right to dismiss" theory has played.

The factors behind policy discussion are as follows.

—In the event that a dismissal is determined null and void, employers are expected to pay lost wages (the wages the employee should have earned), because the employment contract is considered to have continued to exist.

—Moreover, while in the theory it is possible for the employee concerned to resume their employment, it is difficult for them to do so when the employer does not approve resumption of employment, as the employee is not considered to have the right of reinstatement.

This is why the introduction of a system for the monetary resolution of dismissal disputes is being discussed.

B. Collective / Economic Dismissal

In Japan, employment adjustment is largely made by reducing overtime hours or using other means without dismissing regular employees. Companies have tried as far as possible to avoid eliminating regular employees from the company unless the business is in particularly severe difficulty. This is due to the fact that for various reasons Japanese companies place importance on long-term continuous employment, and the fact that the "abuse of the right to dismiss" theory has made it difficult to actually dismiss employees.

While there are no explicit statutory provisions regarding collective/economic dismissal, a legal theory known as the "collective/economic dismissal" theory (*Seiri-kaiko hōri*) has been formed on the basis of precedents from the lower courts (The *Omura Nogami* case, Nagasaki District Court Omura Branch, [Dec. 24, 1975] 242 *Rohan* 14; and the *Toyo Sanso* case, Tokyo High Court [Oct. 29, 1979] 30 *Rominshu* 1002). This theory was derived from the "abuse of the right to dismiss" theory.

Under the "collective/economic dismissal" theory, judgements as to whether a collective/economic dismissal is null and void are made by closely examining the facts of each case on the basis of the following "four criteria" regarding the employer's situation and actions.

Whether the employer (i) had the business necessity to reduce the number of employees, (ii) did its utmost to fulfil its duty to endeavor to avoid dismissal, for instance, by reducing overtime hours, transferring employees within the company or making temporary transfers to another company while maintaining employment relationship with the original company (*shukkō*), ceasing to hire new employees, temporarily suspending business, soliciting voluntary resignation, or reducing the number of non-regular employees, (iii) used objective and reasonable standards for selecting the employees to dismiss (for instance, the number of times an employee has been late or absent, a history of behavior infringing upon company discipline, or a relatively low financial impact for the employee such as in the case of an employee without dependents),

and (iv) provided sufficient explanation regarding the developments leading up to the collective / economic dismissal and the timing when and method by which it would be carried out, etc., and then engage in discussions with the employees or the labor union, listening to opinions and making an effort to secure employees' understanding.

This method of making judgements based on the "four criteria" above is thought to have been developed on the basis of Japanese companies' approaches to employment adjustment. The fact that this theory demands multiple concrete grounds for dismissal—unlike the case of dismissals in general, which result from factors such as a lack of ability on the part of the employee—is thought to be because collective / economic dismissals are only allowed as a result of the financial circumstances of a company.

II. Refusal to renew fixed-term contracts

When a term specified in a fixed-term contract expires, it stands to a reason that the contract will be terminated. But there are also cases in which the contract relationship is continued or repeatedly renewed beyond the agreed term. Because the expiration of the agreed term is not dismissal, the "abuse of the right to dismiss" theory is not applied directly when the disputes appears in the court. Moreover, it is the non-regular employees that are employed under such contracts. There is therefore a greater tendency for them to be the target of employment adjustment, in comparison with regular employees whose dismissal are strictly restricted under the theory. Such termination of the contract relationship due to the expiration of the contract term is known as *Yatoi-dome* (refusal to renew a fixed-term contract).

There are two main types of fixed-term contract where refusal to renew is addressed as a problem in the court: (i) Cases in which the employee fulfils the same duties and is under the same employment management as employees working under open-ended contracts, and the renewal procedures at the time of the expiry of the contract term have not be conducted appropriately (The *Toshiba Yanagimachi Factory* case, Supreme Court, First Petty Bench [Jul. 22, 1974] 28 *Minshu* 927). That is, in this kind of case, issue is whether the employment relationship is in reality similar to employment under an open-ended contract. (ii) Cases in which the contract term is clearly defined, and the contract renewal procedures have been appropriately conducted, but the employee is expected to continue their employment (The *Hitachi Medico* case, Supreme Court, First Petty Bench [Dec. 4, 1986] 486 *Rohan* 6). In this kind of case, it is the main issue whether there can be found employees' expectation to continue their employment relationship with looking precisely into every circumstances in the case.

In addressing the refusal to renew fixed-term contracts of non-regular employees, courts have applied the "abuse of the right to dismiss" theory by analogy and declared the refusal to renew contracts on the basis of the expiry of the contract term to be null and void when the refusal to renew the contract lacks objectively reasonable grounds and is not considered to be appropriate in general societal terms, therefore determining that the original contract relationship remains in place (the fixed-term contract is deemed renewed). This is known as the "refusal to renew fixed-term contracts" theory (*Yatoi-dome hōri*). The essence of this theory has been incorporated in the Labor Contracts Act as Article 19 by the 2012 amendment.[1]

There is also the issue of whether it is acceptable to terminate a fixed-term contract midway through the contract period.

Article 628 of the Civil Code permits the immediate termination of the contract by the parties involved in cases where there are unavoidable reasons. If the unavoidable reasons have arisen from the negligence of either of the parties, that party shall be liable to the other party for damages. However, it is not necessarily clear on whether it is possible to terminate a fixed-term contract midway through the contract period if there are no unavoidable reasons for doing so.

Therefore, the Labor Contracts Act, Article 17 (Paragraph 1) prescribes that in regard to the termination of a fixed-term contract by an employer, "an Employer may not dismiss a Worker until the

expiration of the term of such labor contract, unless there are unavoidable circumstances," clearly restricting the right of the employer to terminate a fixed-term contract during the contract period. Unavoidable circumstances are interpreted as grave circumstances that may invalidate the specification of the term within the contract. Possible examples of this are difficulty continuing to operate the business, difficulty to perform work, or severe non-fulfillment of obligations or illegal conduct.

Furthermore, the 2012 amendment to the Labor Contracts Act prescribes that in cases where fixed-term employment contracts have been repeatedly renewed, and the total continued contract term exceeds 5 years, in the event that the employee applies to the employer for the conclusion of an open-ended contract (that is, exercises the right to apply to convert to open-ended employment), the employer will be deemed to have accepted said application (Article 18). In other words, the amended act enables such atypical employees to convert from fixed-term to open-ended contracts. This provision was set up to eliminate the instability of the employment of fixed-term contract employees. While the "refusal to renew fixed-term contracts" theory only allows for the renewal of fixed-term contracts by a court ruling, this provision is an important policy measure that transcends the legal effect of above theory.

However, some major companies are indicating a policy with which they will once terminate fixed-term contracts intending its total continued contract period will not reach qualified continued 5 years and over to convert to open-ended contracts. Whether the contract period fulfills qualified continued 5 years depends upon the length of an interval ("vacant term") between one fixed-term contract and the subsequent fixed-term contract. Statutory provision specifies that in the event that there is a vacant term more than 6 months between one contract and the subsequent contract, the total contract period will not be regarded as continuous and the contract period that expired prior to the vacant term is not included in the total continued contract period. It is therefore difficult to clearly anticipate the future of policies concerning stabilizing employment for non-regular employees on fixed-term contracts.

* This is a series of three articles on the topic of the termination of employment relationships in Japan. Part I (April-May issue, vol.2, no.6) looks at resignation and termination of employment contracts by mutual consent. Part III (October issue) will cover the mandatory retirement age system.

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1. Article 19 of the LCA stipulates that "If, by the expiration date of the contract term of a fixed-term labor contract which falls under any of the following items, a Worker applies for a renewal of the said fixed-term labor contract, or if a Worker applies for the conclusion of another fixed-term labor contract without delay after the said contract term expires, and the Employer's refusal to accept the said application lacks objectively reasonable grounds and is not found to be appropriate in general societal terms, it is deemed that the Employer accepts the said application with the same labor conditions as the contents of the prior fixed-term labor contract:
(i) the said fixed-term labor contract has been repeatedly renewed in the past, and it is found that terminating the said fixed-term labor contract by not renewing it when the contract term expires is, in general societal terms, equivalent to terminating a labor contract without a fixed term by expressing the intention to fire a Worker who has concluded the said labor contract without a fixed term;
(ii) it is found that there are reasonable grounds upon which the said Worker expects the said fixed-term labor contract to be renewed when the said fixed-term labor contract expires."