

Binding Effect of Unilaterally Modified Rules of Employment Introducing a Performance-based and Ability-based Wage System

The *Trygroup* Case

Tokyo District Court (Feb.22, 2018) 2349 *Rokeisoku* 24

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I. Facts

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X was hired in August 2012 to engage in general affairs, finance and accounting, etc. at Y Co., Ltd., which operates home tutoring and cram schools. On October 1 of the same year, X and Y concluded an open-ended employment contract with basic salary of 429,000 yen. On March 1, 2013, Y proposed to X a change in working conditions with a contract term of 6 months and a basic salary of 310,000 yen, but X did not agree to this. After that, Y made several proposals for changing working conditions to X, but X did not agree to them.

Y paid a basic salary of 343,000 yen to X from the payment on June 25, 2013, and ordered X to be seconded to affiliate Y1 on July 22, 2013. On November 7, 2013, X filed a claim to the Labor Tribunal for invalidation of secondment against Y. In the Labor Tribunal process, mediation was established which included payment for reduced wages and confirmation that renewal of secondment would not be made.

Along with the end of the secondment, Y ordered X to work with AC affairs (receivable collection work by phone) in the general affairs and personnel department on August 11, 2014. On February 20, 2015, X was transferred to the teacher management division, and on October 17, 2017, X was transferred to the AC collection division again.

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Y revised its rules of employment and salary regulations (which formed part of the rules of employment), etc. on March 29, 2014 and April 1, 2014, and made major modifications regarding the salary system, payment criteria, etc.

In the former salary regulations, salaries were abstractly determined in consideration of the quality of work assigned to employees and their age, experience, working results, working conditions, etc. In the new salary regulations, by contrast, salaries were determined based on assessment and evaluation by class rank scale tables classifying the quality of work assigned to employees, their age, experience, working results, working conditions, etc.

With regard to the salary system, while the standard wage in the former salary regulations was divided into the basic salary and a position allowance, in the new salary regulations, a functional allowance was added, and the names, contents, etc. of non-standard wages (such as allowances) were adjusted.

Furthermore, while the former salary regulations did not have an explicit provision for pay reduction, the new salary regulations stated that, "Pay raises and reductions concerning the functional allowance and the position allowance for staff below a manager position are determined based on a personnel evaluation conducted in May and November every year." With regard to promotions and demotions, it was stipulated that as a result of the personnel evaluation in the previous article, with the promotion

or demotion of classes, the functional allowance and the position allowance would also be raised or reduced. Under the new salary regulations, raising and reducing of the allowances and promotions and demotions of employees' position are clearly associated with personnel evaluations.

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Y paid wages to employees including X based on the new salary regulations from November 2014. X was positioned at rank 47 in class J3 for the functional allowance, and the new salary was set at a basic salary of 200,000 yen, a functional allowance of 228,000 yen, and an adjusted salary of 1,000 yen (for a total amount of 429,000 yen, and the total amount was the same as the previous month).

Y performed a personnel evaluation based on the new salary regulations and personnel evaluation regulations in November 2014, and the evaluation result of X was the lowest F rank. As a result, X's functional allowance decreased by 15,000 yen to 213,000 yen. In all subsequent personnel evaluations, X received the lowest evaluation, and the functional allowance was reduced by 15,000 yen each time.

II. Judgment

Dismissal with prejudice on the merits.

1. Effectiveness of the Modification in the Rules of Employment

In the new salary regulations implemented by the modification in rules of employment, the basic salary that accounted for most of the wages in the former salary regulations was divided into the basic salary and the functional allowance. For general employees who work in Tokyo, like X, the basic salary would be 200,000 yen. As for the functional allowance, it has become possible to have a reduction in pay up to 10,000 yen to 15,000 yen depending on the class, once every half year, according to the result of the personnel evaluation. The new salary regulations changed the old seniority-based sequential wage system into a performance-based and ability-based wage system based on personnel evaluations. Under the new salary regulations, depending on the result

of the personnel evaluation, the amount of wages may be reduced. Because such a possibility exists, it should be said that the change from the former salary regulations to the new salary regulations correspond to a disadvantageous modification of the rules of employment.

With regard to disadvantageous modifications in rules of employment, the working conditions shall be as specified in the modified rules of employment only when it is reasonable considering the degree of disadvantage received by workers, the necessity of changing working conditions, the appropriateness of the contents of the rules of employment after the modification, negotiations with labor unions, etc., and other circumstances related to modifications in the rules of employment, and when the modified rules of employment are known to the workers.

When changing a seniority-based wage system to a performance-based and ability-based wage system based on personnel evaluations according to the rules of employment, it should be said that the framework for judging the reasonableness of the modification in the rules of employment is different in a case on the one hand, in which the total amount of funds for wages decreases, and in a case on the other hand, that is, the total amount of funds does not decrease, and it is not disadvantageous for workers as a whole compared to the past, and preferably increases and decreases in the wages of individual workers occur as a result of personnel evaluations. That is, except when the total amount of wages decreases, if it does not decrease, it is the result of personnel evaluations of the relevant workers that directly and practically reduces the wages of the individual workers, rather than the result of the wage system change itself. Therefore, in determining the degree of disadvantage to workers and the reasonableness of the contents of the modified rules of employment, whether the equality of the results of pay raises, promotions, pay reductions, and demotions based on personnel evaluation criteria and evaluation results is ensured, considering the evaluation subject, method and criteria of evaluation, disclosure of evaluation, etc., whether there is a certain institutional security to prevent misuse by

the employer in personnel evaluation, the necessity of the modification in the rules of employment, and the circumstances concerning the change shall be considered comprehensively.

(1) Necessity of change

After integrating the business of group company Y1 and transferring the company's employees to Y, important working conditions were different between Y1 and Y, so it was necessary to unify working conditions among workers from Y1 and from Y.

Given the situation of intensifying competition, there was a need to acquire experienced personnel, motivate them to perform their duties, and increase their retention.

(2) Ensuring equality of pay raises and promotions

The change in the wage system did not reduce the total amount of funds for wages of employees, but it changed the method of determining wage amounts and the distribution method of wage resources to a more rational one. The amount of wages for each employee under the new wage system was determined based on personnel evaluations of the employee, and there may be pay raises, promotions, reductions, or demotions depending on the results of the personnel evaluations for each employee. Equality is secured in this sense.

Since the total wages did not decrease as a result of the modification in the rules of employment, whether a certain institutional security to prevent deviation and misuse of the employers' discretion in personnel evaluations is provided will be important in determining the effectiveness of the modification.

(3) Reasonableness of personnel evaluation system

In the case of personnel evaluations, how to configure evaluation items and how much importance to assign to which items reflects business management perspectives, such as what kind of performance is expected of the employee in current and future business operations, and what kind of ability development and human resource development are planned for that purpose. Because

of this, it should be said that it is up to the discretion of the employer as a rule to decide the evaluation items, which items are to be emphasized and their reflection in the salary.

When looking at each evaluation item of the accreditation from this point of view, there are no evaluation items that should be regarded as instances of Y having misappropriated discretion. The personnel evaluation system in Y is conducted by a plurality of evaluators in accordance with evaluation items determined in advance, whereby it is secured to a certain extent that the personnel evaluation is performed objectively, and the evaluation results are to be returned to the person undergoing evaluation. It can be said that a certain institutional security is provided to prevent arbitrary personnel evaluations for illegal and unfair purposes. Also, because it is intended to be utilized for human resource development through the improvement of work ability, it can be said that there is reasonableness as a system, that is, reasonableness of contents of new rules of employment, etc.

As for the procedure for changing the rules of employment, although there seems to be no labor union in Y, after completing the proposal of the new rules of employment, there was a brief period in which interviews were conducted through employee representatives. An opinion from the employee representatives that there were no particular problems was obtained, and it can be considered that the interviews gave the employees at least an opportunity for negotiations with their employer.

To summarize the above facts, this modification in the rules of employment introduces a performance-based and ability-based wage system that meets management needs, and does not reduce the total amount of funding for wages. It should be said that it is effective because the system will be changed to a new rational system, in which pay raises and reductions are based on a personnel evaluation system with certain institutional collateral to prevent deviation.

2. Applicability of Proviso to Article 10 of the Labor Contracts Act

For the proviso to Article 10 of the Labor Contracts Act to be applied, it is not necessary to expressly agree that there will not be a modification depending on the rules of employment. It is necessary to have sufficient circumstances to interpret and evaluate that the parties have reached an agreement that the working conditions will not be changed by the rules of employment.

(i) The reason why the monthly salary of X was decided to be 429,000 yen in the employment contract is as follows. In the hiring interview with Y, X said that the annual salary of X's previous job was 7.2 million yen and at least 6 million yen would be necessary. It was decided to make 429,000 yen per month by rounding up 428,571 yen, which was 6 million yen divided by 14 months. (ii) In the wage column of the employment contract, there is a provision for pay raises and reductions (demotions) according to the rules of employment. In addition, it is recognized that there is no provision to exclude any method of modification other than an agreement with X for the wage amount.

The amount of the wage for X was determined by negotiation during the hiring interview, and was not calculated by formally applying the former rules of employment and the former salary regulations.

However, on the other hand, the employment contract provides that pay raises and reductions (demotions) are based on the rules of employment, and the wage amount varies according to the mechanism defined in the rules of employment and salary regulations. In the case of X, it is understood that it is not based on the premise that an individual agreement is necessary when raising the salary. X is just an ordinary employee, and the employment contract is not considered to be based on specific working conditions that are different from those of other employees, and it is not an annual salary system in which wage amounts are scheduled to be changed by annual agreement. Considering the circumstances described above, for X and Y, it cannot be accepted that the wage amount of X has been agreed as a working condition that will not be changed by

changing the rules of employment. Moreover, if Y's wage system has undergone a major change that changes the wage determination mechanism itself, it cannot be accepted as an agreement to treat the wage amount set at the time of entering into an employment contract as a specific contract.

In contrast, X argues that the former rules of employment have a provision for demotions, but that there is no provision for a wage reduction, so it cannot be said that a wage reduction was scheduled for the employment contract. However, the issue here is whether it can be evaluated that the agreement on the wage amount in the employment contract is established as a working condition that will not be changed by the rules of employment. In light of the above mentioned circumstances such as the assumption that wage amounts fluctuate according to a prescribed mechanism such as rules of employment, it should not be evaluated that such an agreement has been established.

In addition, if there is no provision for wage reduction, whether or not it can be newly established by the method of changing the rules of employment has already been examined as a matter of reasonableness for changing the rules of employment.

III. Commentary

1. Significance and features of this judgment

In this case, when a wage system based on seniority is changed to a performance-based and ability-based wage system based on personnel evaluation by unilaterally modifying the rules of employment, it is the first judgment that clearly states that the framework for determining the reasonableness of modifications in the rules of employment differs depending on whether the total amount of funds for wages decreases or not. In particular, if the total amount of funds does not decrease, the court said that the wage decreases of individual workers were not the result of the wage system change itself, but the result of personnel evaluations of the specific workers. Instead of considering *the degree of disadvantage that the individual worker suffers*, a distinctive judgment

framework was presented to examine in detail the *appropriateness of the contents of the changed rules of employment*. As a result, X as an individual suffered a major disadvantage of a reduction in pay of 15,000 yen once every six months depending on the results of the personnel evaluation, but this point was not taken into consideration in the judgement.

2. Case law on disadvantageous modification of the rules of employment and Article 10 of the Labor Contracts Act

In order to perform efficient and rational business management using a large number of workers, it is necessary to uniformly set working conditions and workplace regulations. Rules concerning working conditions and workplace regulations that are uniformly applied to all workers in the workplace, established by employers for such business management needs, are called “rules of employment.”

Regarding modifications in the rules of employment, the employer must listen to the opinions of a representative of a majority of employees at the workplace (a union that organizes a majority of workers at the workplace, or a worker selected by a majority of workers if such a union does not exist) (Labor Standards Act, Article 90, Paragraph 1). When submitting the rules of employment to the administrative agency, a document stating the above-mentioned opinion must be attached (Labor Standards Act, Article 90, Paragraph 2). However, in the sense that the consent with a majority of employees is not a legal requirement, the rules of employment can be unilaterally established or modified by the employer. Therefore, when the employment rules are modified unilaterally by the employer, on what basis this is binding on workers who oppose it became a critical legal issue.

Theories and judicial precedents developed various arguments over the issue, but a 1968 Supreme Court Grand Bench decision introduced a unique doctrine that, if the modification of the rules of employment is regarded as a reasonable one, workers who opposed it would also be bound by it. This was supported by the Supreme Court

for about 40 years, and was incorporated in the Labor Contracts Act as Article 10 in 2007. That is, “When an Employer changes the working conditions by changing the rules of employment, if the Employer informs the Worker of the changed rules of employment, and if the change to the rules of employment is reasonable in light of the extent of the disadvantage to be incurred by the Worker, the need for changing the working conditions, the appropriateness of the contents of the changed rules of employment, the status of negotiations with a labor union or the like, or any other circumstances pertaining to the change to the rules of employment, the working conditions that constitute the contents of a labor contract are to be in accordance with such changed rules of employment; provided, however, that this does not apply to any portion of the labor contract which the Worker and the Employer have agreed on as being working conditions that are not to be changed by any change to the rules of employment...”

“Underlying this ruling is a consideration for employment security and the need for flexible adjustment of working conditions. Traditional contract theory dictates that a worker who opposes any modifications made to the future terms of employment be discharged. However, according to the strict restriction on dismissals by the prohibition of abusive dismissals in Japan, such a dismissal may well be regarded as an abuse of the right to dismiss, and thus, rendered null and void. However, since the employment relationship is a continuous contractual relationship, modification and adjustment of the working conditions is inevitable.”¹ Therefore, a unique rule that admits the binding effect of unilaterally modified rules of employment without workers’ consent on the condition that the modification can be deemed reasonable was formed by case law and incorporated in the Labor Contracts Act in 2007.

According to Article 10 of the Labor Contracts Act, if an employer intends to change the working conditions disadvantageously by changing the rules of employment, and the two requirements are satisfied—namely, (i) inform the workers of the

changed rules of employment, and (ii) the changes to the rules of employment are reasonable—the working conditions will be changed to the contents stipulated in the changed rules of employment. Depending on the results of the personnel evaluation, the wage may be reduced for individual workers. Therefore, the judgement is that the change from the former salary regulations to the new ones is a disadvantageous change in the rules of employment. It follows the judicial precedents and is reasonable.

3. The framework for determining the reasonableness of disadvantageous modifications in rules of employment in this case

The judgement said that the framework for determining the reasonableness of modifications in rules of employment should be different depending on whether the total amount of wage funding is reduced, because it is the result of personnel evaluation of the workers in question which is the reason for reducing the wages of individual workers directly and practically. As mentioned above, in order for a disadvantageous modification in rules of employment to bind workers who do not agree with it, the modification in them must be reasonable. When judging whether there is reasonableness, “degree of disadvantage to workers” is listed as one of the factors to consider in Article 10 of the Labor Contracts Act. Also, “the degree of disadvantage that a specific worker receives” and “the degree of disadvantage that all workers receive” do not necessarily coincide. For example, in this case, the change to a performance-based and ability-based wage system is mainly aimed at the redistribution of wage resources among workers, so even if the total wage resources are not reduced, there are always workers at the individual level who lose their share and suffer disadvantages. In particular, in the case of X, it is true that the wages were reduced by 15,000 yen every six months, resulting in a large disadvantage. From the viewpoint of all workers, even if the total wage fund does not decrease, it does not mean that the degree of disadvantage actually suffered by certain workers at the individual level does not have to be a problem.

In addition, the “degree of disadvantage received by workers” and “appropriateness of the contents of the modified rules of employment” listed in Article 10 of the Labor Contracts Act are both independent judgment factors for determining the reasonableness of changing the rules of employment. The judgment as to whether the contents of the modified rules are appropriate is not directly related to the judgment of the degree of disadvantage received by (individual) workers.

As a result, neither “no reduction in the total amount of wage resources” nor “the reasonableness of the contents of the new rules of employment, etc.” is a reason for not judging “the degree of disadvantage that an individual worker receives.” In this case, in order to determine the reasonableness of the disadvantageous modification in the rules of employment, in accordance with the judgment framework of Article 10 of the Labor Contracts Act, it was necessary to comprehensively examine the degree of disadvantage received by workers (viewed from the two viewpoints of individual workers and all workers), the necessity of the change of working conditions, the appropriateness of the contents of the modified rules of employment, negotiations with trade unions, etc., and other circumstances.

4. The “individual specific agreements” in the proviso to Article 10 of the Labor Contracts Act

Flexicurity, a social policy balancing flexibility and security, in Japan is realized by giving employers the right to flexibly adjust working conditions under the case law on disadvantageous modification of the rules of employment while ensuring the stability of employment. While the rule on disadvantageous modification of the rules of employment is for the uniform and collective change of working conditions, it is necessary to secure the area of individual contract autonomy and respect workers’ self-determination. The proviso to Article 10 of the Labor Contracts Act is created to meet the need for such individual autonomy. Where the “individual specific agreements” in the sense of Proviso to Article 10 exist, the agreements take precedent over the rule on disadvantageous modification of the rule

of employment.

However, if such individual specific agreements could be largely admitted, that would potentially undermine the function of the case law for uniform and collective modification of working conditions, which would lead the rigid employment system lacking flexibility to respond to constantly changing market demands. Therefore, in order to establish an individual specific agreement, it is necessary for there to be sufficient circumstances to recognize that an agreement has been reached as certain working conditions will not be changed by the rules of employment.

In this case, the wage amount of X was determined by negotiation during the hiring interview. However,

in order to recognize the establishment of an individual specific agreement, it is necessary to have enough circumstances to recognize that a change in the wage amount of X excludes any method other than agreement with X. In this case, since such facts are not recognized, the establishment of individual specific agreements is not permitted.

1. Takashi Araki, “The Relationship between State Law, Collective Agreement and Individual Contract: Japan’s Decentralized Industrial Relations with Internal Market Oriented Flexicurity,” *University of Tokyo Journal of Law and Politics* 10 (Spring 2013): 15.

The *Trygroup* case, *Rodo Keizai Hanrei Sokuho (Rokeisoku, Keidanren Jigyo Service)* 2349, pp.24–45. See also *Journal of labor cases* (Rodo Kaihatsu Kenkyukai) no.75, June 2018, pp.34–35.

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