

## Do Educational Loan Programs Exempting Repayment of School Expense Lent by Hospitals on Condition of Working for Certain Periods Violate Article 16 of the Labor Standards Act?

The *Kyoyukai Misumi Hospital Case*

Hiroshima High Court (Sept. 6, 2017) 1202 *Rodo Hanrei* 163

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### I. Facts

X<sub>1</sub> passed the entrance examination for School of Assistant Nursing A in March 2005, and was hired by Y, a medical corporation that manages hospitals, to work as a nursing aide starting on April 1 that year while attending school. In February 2007, X<sub>1</sub> passed the Assistant Nursing Examination, and in March that year graduated from School of Assistant Nursing A. Y suffered from a chronic shortage of nurses, and encouraged staff who were working while attending School of Assistant Nursing A to obtain nurse certification. Thus, starting in April, X<sub>1</sub> attended Nursing School B while working as an assistant nurse in Y. Afterward X<sub>1</sub> passed the nurse examination, graduated from B in March 2010, and has been working at Y as a nurse since April 1, 2010.

Y had a program offering interest-free educational loans for those who wanted to work for Y. Its main contents were as follows:

—Educational Loan period is from the day the loan is decided upon until the month the borrower graduates from school (Article 2 of the loan agreement).

—Borrowers who have graduated from school and worked at Y for certain years (4 years after graduation for assistant nurses, or 6 years for nurses) are fully exempt from repayment (Article 5 of the loan agreement).

—Educational loans must be repaid in full under the following circumstances, although repayment may be reduced in amount, waived, or delayed

when students withdraw from school or resign from their jobs due to unavoidable reasons such as illness (Article 6 of the loan agreement).

(1) If a student withdraws from school

(2) After obtaining certification, if a student does not work for Y, or resigns from Y before the prescribed period has elapsed

When enrolling at schools A and B, X<sub>1</sub> submitted an educational loan application to Y and received the loan, with X<sub>2</sub>, the father of X<sub>1</sub>, as the guarantor. X<sub>1</sub> decided to resign from Y in or around May 2014. On asking Y's medical office manager C and section chief D about potential contract issues that would be raised by resignation, X<sub>1</sub> was not told that educational loan repayment would be required. Under these circumstances X<sub>1</sub> resigned on August 20, 2014.

Y filed a lawsuit against X<sub>1</sub> and guarantor X<sub>2</sub>, seeking full repayment of the educational loan to X<sub>1</sub> on the grounds that X<sub>1</sub> resigned before working for the prescribed number of years. The first instance (Yamaguchi District Court, Hagi Branch [Mar. 24, 2017] 1202 *Rohan* 169) dismissed Y's claim, and Y appealed.

### II. Judgment

The Tokyo High Court dismissed Y's appeal (Y's demand for payment). The following is an overview



of the court's judgment.

(1)  $X_1$  and  $X_2$  claim that repayment is not required, and that a requirement for the educational loan to be repaid was not explained to them. However, it is clear that the document submitted by  $X_1$  is a loan application. Also, a guarantor was required for this educational loan. Therefore, it cannot be said that there was no agreement to repay the loan.

(2) However, of the funds loaned by Y to  $X_1$ , the portion loaned to  $X_1$  when the latter was attending School of Assistant Nursing A is exempted from repayment because, as stipulated by the regulations,  $X_1$  worked for Y for 4 years or more after graduating from School A.

(3) Article 16 of the Labor Standards Act (LSA) stipulates that "Employers shall not make a labor contract which predetermines either a sum payable to the Employer for breach of contract or an amount of compensation payable for damages," and this could also be applied to loan agreements (formally signed independently of labor contracts).

Therefore, in the light of the purpose and content of this educational loan, the loan can be judged as violating Article 16 of the LSA if the obligation to repay the loan is deemed to unduly restrict  $X_1$ 's freedom to resign from a job.

Article 14 of the LSA stipulates that the period of a fixed-term labor contract is, as a basic rule, limited to 3 years. Therefore, whether this case can be judged as "unduly restricting freedom to resign from a job," and whether the period for which the employee is effectively prohibited from resigning is longer than 3 years, should be considered important criteria here.

(4) Y recommended that  $X_1$  attend nursing school due to Y's need to secure nurses. Thus, the fact that  $X_1$  acquired a nurse certification is directly related to  $X_1$ 's working for Y.

There was an agreement between Y, and  $X_1$  and  $X_2$  stipulating the latter's repayment of the educational loan (see [1]). On the other hand, explanation of the agreement's contents was insufficient, and at the time  $X_1$  submitted a letter of resignation,  $X_1$  was unable to recognize these contents clearly.

The period of nurses' full exemption from

repayment is 6 years, far longer than the maximum length of a fixed-term labor contract stipulated by the LSA. Y asked for full repayment, ignoring the fact that  $X_1$  worked at Y for 4 years and 4 months after obtaining a nurse certification. The amount Y sought to have  $X_1$  and  $X_2$  repay was 10 times  $X_1$ 's base salary. Thus, the actual effect of the obligation to repay it was to seriously restrict  $X_1$ 's freedom to resign.

(5) Based on the above, the agreement drawn up by Y stating that  $X_1$  is to repay educational loan for Nursing School B, containing provisions regarding the period of exemption from repayment obligation and obligations to repay in the case stipulated in Article 6, constitutes an economic obstacle that unduly restricts  $X_1$ 's freedom to resign and as such violates Article 16 of the LSA. Therefore, the contract between Y and  $X_1$  relates to financial aid as a benefit and does not contain an agreement to repay. As a result, Y's demand for repayment is invalid.

### III. Commentary

The matter disputed in this case is the legality of a system in which staff working at a hospital who have made a loan for the school expense of nursing school to obtain a nurse certification, and are expected to be exempted from repayment on condition of working for the hospital for a certain period after obtaining the certification (if they leave the job during this period, they are required to repay the loan).

Article 16 of the LSA prohibits employers from "making a labor contract which predetermines either a sum payable to the Employer for breach of contract or an amount of compensation payable for damages." In pre-World War II Japan, many employers had an unethical practice of imposing penalties for leaving jobs or returning to hometowns in the middle of a contract period, in effect, restricting workers' freedom and rendering them subservient. Article 16 of the LSA was established to prevent such undue restrictions by employers.

Today, employers sometimes bear the cost of workers' training or study abroad in order to have workers enhance abilities and vocational skills, or obtain certifications. If workers then immediately

resign after they have obtained certifications, etc., it becomes a total loss for employers. For this reason, it is a common practice for employers to “make a loan plan” covering the cost of the study to workers, and exempt them from repayment of the loan if they work for the employer for a certain period after the completion of study (if they resign during this period, they will be liable for repayment.) Contracts of this nature appear to stipulate “a sum payable to the Employer for breach of contract if a worker does not work for a certain period.” Thus, whether this violates Article 16 of the LSA is an issue for debate.

Court decisions on such cases are divided. Some have found that workers by rights ought to be liable for voluntary educational expenses (without immediate relation to work), and a system in which they are exempted from repaying loans for such expenses on the condition of working for a stipulated period does not violate Article 16 of the LSA. On the other hand, requiring payment if employees do not work for a certain period when education constitutes vocational training (and/or is ordered by the employer) is in violation of said Article. However, it is difficult to distinguish between these two types of cases. More specifically, courts take the following factors into consideration: (i) Whether study, etc. is voluntary or involuntary—whether it is workers’ option or order by the employer, (ii) Relevance between the content of study, etc. and work—if it is barely relevant, a loan, etc. is considered support for voluntary study, whereas if it is highly relevant, it is considered an expense that ought to be borne by employers, (iii) Reasonableness of conditions for exemption from repayment—if the amount to be repaid is too large or the period to be worked in order to be exempted from repayment is too long, it is deemed to “unduly restrain” the employee, (iv) Reasonableness of repayment procedures—if payment in installments is accepted, or amount to be repaid is reduced according to years of service after completing the education the procedure is deemed not to be unreasonable as the restricting effect on employees is small. These factors are comprehensively considered, and a judgment is made on whether conditions constitute “unduly

restricting freedom of resignation.”

In this case, the issue is a loan of school expense to obtain nurse certification (national license), thus the relation between the certification acquired through study and the work performed for the employer is very strong. Underlying the conditions imposed is a shortage of nurses at Y. Therefore, it can be judged that demanding repayment of an educational loan when an employee resigns within a certain period prevents the employee from resigning by imposing the cost which should be borne by employers as their business cost. The court’s judgment of violating Article 16 of the LSA is considered valid.

However, the following key feature of this decision should be noted. There was an emphasis on the period of service required before exemption from repayment, with the maximum length of a fixed-term labor contract stipulated by the LSA as the standard. Article 14 of the LSA states that the period of a fixed-term labor contract is, as a basic rule, limited to 3 years. The purport of Article 14 of the LSA is that an overly long contract period prevents workers from resigning and unduly restricts their freedom. However, some questions can be raised with regard to this reasoning.

First, regarding the maximum length of a fixed-term labor contract under Article 14 of the LSA, a supplementary provision states that a worker can resign freely once one year has passed after conclusion of a labor contract (Supplementary Article 137 of the LSA). This supplementary provision was added out of concern that a 3-year fixed-term labor contract could have the effect of unduly restricting personal freedom to leave jobs. Thus, when the court decision refers to the maximum length of fixed-term contracts that limits freedom of resignation, the provision to be referenced should not be Article 14, but Supplementary Article 137 of LSA, which stipulates that workers are free to resign after 1 year. However, this court decision overlooks Supplementary Article 137.

Second, the scope of cases that reference the limit on length of fixed-term labor contracts as defined by Article 14 of the LSA is not clear. One precedent was a case regarding voluntary study-abroad expenses

that had a low degree of relevance to work, and a system of exempting repayment on the condition of 5 years of service was judged to be legally valid (the *Nomura Securities Co. Case*, Tokyo District Court [Apr. 16, 2002] 827 *Rohan* 40). Another provision, although it relates to public officers, which sets the period of service required for exemption from repayment of expenses at 5 years, in cases where officers resign of their own accord after studying abroad (Act on Reimbursement of National Public Officers' Expenses for Studying Abroad Article 3, paragraph 1, item 2).

In addition, generally in such cases regarding educational loan program and repayment of school expense, if it is judged that Article 16 of the LSA is being violated, then repayment of the full amount of expenses is exempted, but if Article 16 is not

violated, then employers can seek repayment of the full amount of expenses (within the scope of the system established by employers), and it has been pointed out that it is not appropriate to come to an “all or nothing” conclusion in such cases (Takashi Araki, *Rodoho* [Labor and employment law], 3rd ed. [Tokyo: Yuhikaku, 2016] 77). The above-mentioned Act on Reimbursement of National Public Officers' Expenses for Studying Abroad states that if an officer resigns within 5 years after studying abroad, the amount to be repaid is not the full amount, but rather is proportionally reduced according to the length of service after studying abroad.

The *Kyoyukai Misumi Hospital case*, *Rodo Hanrei (Rohan, Sanro Research Institute)* 1202, pp.163–168. See also *Rodokeizai Hanrei Sokuho (Rokeisoku, Japan Federation of Employers' Associations)* 2019, pp. 3–16.

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