

## Commentary

### Is it Legal for the Employer to Refuse to Renew a Fixed-term Labor Contract with a Worker Who is a Re-employed Retiree on the Grounds of the Worker's Refusal to Accept Changes in the Working Conditions?

The *Takaoka Toko Co., Ltd (Kabushiki-gaisha Toko Takaoka)* Case  
Tokyo High Court (Oct. 17, 2024) 1323 *Rodo Hanrei* 5

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#### I. Facts

X (plaintiff) held an indefinite-term labor contract with Company A (not a party to the case). Following the termination of the contract upon X's reaching the mandatory retirement age (60 years of age) on September 30, 2020, X concluded a fixed-term labor contract (hereinafter, "Contract 1") with Company A on October 1, 2020, which specified details such as the contract term of one year from the date of contact, four-day workweek, and the basic monthly pay of 303,600 yen. Regarding the continued employment (*keizoku koyo*) of retirees under the age of 65 as stipulated in Article 9, paragraph (1), item (ii) of the Act on Employment Security of Elderly Persons, Company A had prepared the rules for continued employment of retirees (hereinafter referred to as "Company A's continued employment rules") and made them known to its employees. Contract 1 was concluded in accordance with these rules. On July 1, 2021, X applied to Company A for the renewal of Contract 1 under the same working conditions as the previous conditions (hereinafter, the "Application for Renewal").

On July 30, 2021, Company A and Company Y (defendant), which is a parent company of Company A, reached an agreement for the merger wherein Company Y would absorb Company A as of October 1, 2021. Company A was succeeded to by Company Y on that date.

On August 23, 2021, Company A proposed to X two alternative fixed-term labor contracts to be

concluded following the termination of Contract 1: (i) a managerial position with a five-day workweek and monthly remuneration (basic pay of 256,500 yen) for seven-month term (hereinafter, "Proposal 1"); and (ii) a non-managerial position with a four-day workweek and hourly remuneration of 1,200 yen for a term of three years and seven months (hereinafter, "Proposal 2"). In response, X sent a document to Company A to notify that X cannot agree to either Proposal 1 or Proposal 2 because the scope of work was too broad and would result in a significant deterioration of working conditions.

On September 13, 2021, Company A and Company Y presented other proposals to X that revised the content of work of Proposal 1 and Proposal 2 (hereinafter, all proposals from Proposal 1 onwards are collectively referred to as the "Proposals"). However, X did not agree to any of the Proposals. Company Y and Company A did not offer X any further alternatives, and Contract 1 expired without X accepting the contract renewal offer.

On September 30, 2022, one year after the expiration of Contract 1, and again on October 1, 2023, X applied to Company Y for contract renewal under the same working conditions as Contract 1. However, Company Y indicated to X its intention to reject both contract renewal applications.

In this lawsuit, X argued that, based on Article 19, item (ii) of the Labor Contract Act (hereinafter referred to as "LCA"), X had a reasonable expectation that the contract would be renewed at the expiration of Contract 1, but that Company Y's refusal of his

application for renewal under the same working conditions as Contract 1 lacked objectively reasonable grounds and was not found to be appropriate in general societal terms, and sought confirmation of his rights under the labor contract. The Tokyo District Court rendered a judgment on April 25, 2024, to dismiss X's claim, ruling that X is not found to have a reasonable expectation for the contract renewal, and even if X had such expectation, Company Y's refusal of the Application for Renewal is supported by objectively reasonable grounds and therefore is found to be appropriate in general societal terms. Dissatisfied with this, X appealed to a higher court.

## II. Judgment

The court of second instance dismissed X's appeal. The following is a summary of the appellate judgment.

1. "It is interpreted that the phrase '[the worker] expects the said fixed-term labor contract to be renewed' as referred to in Article 19, item (ii) of the LCA is not limited—based on, the wording of that Article—to situations where the renewal is expected under the same working conditions as the prior contract. Rather, it also encompasses situations where the worker expects the said fixed-term labor contract to be renewed under the working conditions that have been changed from the conditions of the prior labor contract."

Contract 1 between X and Company A is the first labor contract for X's re-employment after mandatory retirement. Although it is found that X and Company A had never renewed a fixed-term labor contract, "it is found that Contract 1 was concluded in accordance with Company A's continued employment rules, which serve as a continued employment system introduced under Article 9, paragraph (1), item (ii) of the Act on Employment Security of Elderly Persons, and that these rules provide as follows: the company continues to employ retirees who seek re-employment until they reach the age of 65 years, except for those who fall under grounds for dismissal or other cases prescribed in the company's regulations of

employment; and the term of a labor contract for post-retirement re-employment is one year, and upon the renewal of the labor contract, the working conditions under the renewed contract, including the number of working hours/days and monthly pay, will be determined on a case-by-case basis, while hearing the request from the worker to be continuously employed and taking into various circumstances concerned."

According to the above, "it is found that there were reasonable grounds upon which X expected Contract 1 to be renewed upon the expiration of Contract 1 in their relationship with Company Y, which had succeeded to Company A through the merger, regardless of whether the same working conditions as those of the prior labor contract would be offered (...)."

2. "Company Y is found to have refused X's Application for Renewal."

3. In this case, Contract 1 was not renewed because X did not accept any of the Proposals by Company Y. "The court examines whether Company Y's refusal of the contract renewal lacks objectively reasonable grounds and is not found to be appropriate in general societal terms, including whether the Proposals were reasonable."

"Company A's continued employment rules provide that the term of a labor contract for post-retirement re-employment is one year, and upon the renewal of the labor contract, the working conditions under the renewed contract, including the number of working hours/days and monthly pay, will be determined on a case-by-case basis, while hearing the request from the worker to be continuously employed and taking into various circumstances concerned." It is hard to find that the contract renewal under the same working conditions as those of the first labor contract was guaranteed.

It is found that Company A had posted a current account deficit for three consecutive years since FY2018, and that on July 30, 2021, it was decided that the company would be absorbed by Company Y under absorption-type merger as of the day following the date of expiration of Contract 1. Furthermore, "Company A explained the likelihood of a merger in

which it would be absorbed by Company Y at an explanatory meeting held for its employees including X about five months before the merger, and also at an explanatory meeting held after the merger was decided, Company A explained that it would be absorbed by Company Y as of the day following the date of expiration of Contract 1, and given these explanations, X is found to have been able to recognize that the counterparty to the renewal of Contract 1 was not Company A, but Company Y, which would succeed to Company A.” At the latter explanatory meeting mentioned above, Company A announced that Company A’s continued employment rules would be changed to Company Y’s rules for re-employed older workers, which serve as Company Y’s post-retirement re-employment system, and the changes in the rules were made known to Company A’s employees. Since Company Y’s rules for re-employed older workers provide that the basic pay is 1,200 yen per hour in principle, it is found to be objectively unavoidable that the pay for X under a labor contract to be concluded between X and Company Y after the expiration of Contract 1 would be below the pay offered under Contract 1, and X himself is found to have been aware of the likelihood that changes in the working conditions would be proposed.

Company Y had established its rules for re-employed older workers and internal rules for compensation for managerial positions. It is found that Company A and Company Y presented Proposals 1 and 2 to X about one month prior to the expiration of Contract 1, while specifying the working conditions in accordance with these sets of rules, and that, at that time, about 120 re-employed retirees of Company Y concluded labor contracts in accordance with these sets of rules, with no retiree being re-employed under different conditions. “Based on the foregoing, it is difficult to conclude that there were reasonable grounds upon which X expected Contract 1 to be renewed with Company Y at the time of expiration of Contract 1 under the same working conditions as those previously applied.”

On the other hand, it is difficult to discern any particular necessity for Company Y to re-employ

Company A’s re-employed retirees under their previous working conditions, but rather it appears substantially more necessary for Company Y to re-employ them under the same working conditions applicable to Company Y’s re-employed retirees. “In light of these findings—and given that three other re-employed retirees of Company A accepted Company Y’s proposal and concluded a fixed-term labor contracts with Company Y, and that the work performed by X in Company A falls within the scope of the business that Company Y was scheduled to discontinue, and therefore nothing suggests that X would become busier in Company Y,” it should be said that the Proposals were reasonable even by taking into consideration that the Proposals are less favorable to X than the working conditions under Contract 1 and that Company Y’s business was robust. As it is found that an explanation was given that the Proposals were in line with the conditions applicable to Company Y’s re-employed retirees, the “Proposals cannot be deemed to be inappropriate in procedural terms.”

“According to the above, while it is difficult to find that there were reasonable grounds upon which X expected the Contract 1 to be renewed with Company Y at the time of expiration of Contract 1 under the same working conditions as the previous conditions, the Proposals presented by Company A and Company Y to X are found to be reasonable and cannot be deemed to be inappropriate in procedural terms. It cannot be said that Company Y’s refusal to renew Contract 1 as a result of X’s refusal to accept the Proposals falls under the case where an employer’s refusal of the contract renewal lacks objectively reasonable grounds and is not found to be appropriate in general societal terms, and therefore, Contract 1 is not renewed.”

### III. Commentary

In Japan, there is a general framework that restricts an employer from refusing to renew a fixed-term labor contract upon its termination if certain conditions set out in Article 19 of the LCA are met. Item (ii) of that article stipulates that, if a worker

applies for the renewal of a fixed-term labor contract, and the following two conditions are met, it is deemed that the employer accepts the application for renewal with the same working conditions as previous fixed-term contract: (1) it is found that there are reasonable grounds upon which the worker expects the fixed-term labor contract to be renewed; and (2) the employer's refusal to accept the application for renewal lacks objectively reasonable grounds and is not found to be appropriate in general societal terms. In other words, the legality of an employer's refusal to renew a fixed-term labor contract is examined through the two-stage review that focuses on (1) whether the worker had a reasonable expectation for the contract renewal, and (2) whether the employer's refusal of the contract renewal is supported by objectively reasonable grounds and is found to be appropriate in general societal terms.

Issues concerning an employer's refusal to renew a fixed-term labor contract could also arise in relation to the continued employment system for retirees. In Japan, many companies have adopted the mandatory retirement age, and since the law prohibits setting the retirement age below 60, it is common to set the retirement age at 60. In order to cover the period of income loss between the end of employment and the start of receiving pension — five-year gap caused by gradual increase in the pension eligibility age (in principle, 65 years old)— companies are now legally required to secure employment for their employees until the age of 65. Specifically, Article 9, paragraph (1) of the Act on Employment Security of Elderly Persons obligates companies that adopt the mandatory retirement age to implement one of the following measures: raising the mandatory retirement age; introducing the continued employment system (a system under which elderly persons currently employed by the employer continue to be employed after the mandatory retirement age if they wish); or abolishing the mandatory retirement age. In practice, nearly 70% of these companies have introduced the continued employment system (Ministry of Health, Labor and Welfare, *2024 Report on the Employment Condition of the Elderly Persons*, 3). Under this

system, it is common practice to conclude a fixed-term labor contract for re-employment.

In this case, Company A and Company Y were both employers with continued employment systems. When Company A, which had fallen into financial difficulties, was to be absorbed into Company Y, the two companies offered new working conditions based on Company Y's continued employment rules to workers who had entered into fixed-term contracts with Company A after retirement, including X. It is not uncommon for workers who wish to renew their fixed-term contracts to be offered working conditions that are different from their previous conditions. However, in this case, Company Y refused to renew X's contract because X did not agree to the proposed changes. The central issue was whether Company Y's refusal to renew the contract violated Article 19, item (ii) of the LCA.

In this judgment, the appeal court first addressed how to interpret a worker's expectation of contract renewal under Article 19 of the LCA. The court rejected the interpretation adopted by the court of first instance, which had limited this expectation for the contract renewal under the same working conditions as previously existed, and stated that the expectation referred to in that Article also includes an expectation of renewal under working conditions different from the previous conditions. This suggests that the court clarified its interpretation that Article 19, item (ii) of the LCA to be primarily intended to protect the expectation that employment itself will continue, and that changes in working conditions do not affect the worker's expectation of renewal. The appeal court's interpretation finds support in scholarly literature and prior judicial precedents. One of court decisions held that "renewal" under Article 19, item (ii) of the LCA refers to the conclusion of a fixed-term labor contract with a worker at a point in time immediately following or closely after the expiration of the worker's prior fixed-term labor contract, and does not mean conclusion of a contract for the same contract term or under the same working conditions as the prior contract (the *Kawaijuku Educational Institution* case, Tokyo High Court (Feb. 2, 2022) 1271 Rohan 68). The judgment in the

present case is significant in that it broadly recognized the scope for workers to have reasonable expectation of the contract renewal in light of the purpose of Article 9, paragraph (1) of the Act on Employment Security of Elderly Persons, i.e., securing stable employment until the age of 65.

Next, let us examine how the courts have determined the second issue of whether an employer's refusal to renew a fixed-term labor contract is supported by objectively reasonable grounds and is deemed appropriate in general societal terms. In the cases regarding the deterioration of working conditions proposed at the time of renewal of a fixed-term contract, we can find two approaches in courts' decisions. The first focuses on the necessity to change the working conditions and the reasonableness of the proposed working conditions (forecited the *Kawaijuku Educational Institution* case). In a case in which post-retirement re-employment was concerned, the reasonableness of the working conditions proposed has been considered an important factor in judgment, with emphasis placed on the degree of disadvantage to the worker in analysing whether the employer's refusal of the contract renewal was supported by objectively reasonable grounds and could be deemed appropriate in general societal terms (the Tanaka Oxygen Dealer (refusal of contract renewal, or yatoi-dome) case, Hiroshima High Court (Dec. 25, 2020) 1286 Rohan 68).

However, such approach to determination that focuses on the reasonableness of working conditions has been criticized as setting back the protection for workers' expectation for the contract renewal and undermining the meaning of Article 19, item (ii) of the LCA. The second approach is to acknowledge that the proposed changes to working conditions are reasonable, but not to recognize that reasonableness as the grounds for the employer's refusal to renew the contract, thus denying the legality of the employer's refusal (the *Hilton Japan* case, Tokyo District Court (Mar. 11, 2002) 825 Rohan 13).

In the judgment of the present case, the court focused on the reasonableness of the proposed working conditions in determining whether the

employer's refusal to renew the contract was supported by objectively reasonable grounds and was found to be appropriate in general societal terms, putting greater emphasis on the changes in working conditions than on the continued employment. The conclusion reached in this case aligns with the first approach, i.e., the holdings in the *Kawaijuku Educational Institution* discussed above which underscored the significance of evaluating the reasonableness of changes in working conditions in determining the legality of the employer's refusal to renew the contract.

The court also examined the reasonableness of the Proposals from the perspectives of the necessity to adopt the same working conditions as those of Company Y's re-employed retirees upon the merger, the fact that Company A's re-employed workers, except for X, had signed contracts with Company Y, and the extent to which the proposed conditions were less disadvantageous to X. In this process, the court placed more emphasis on the necessity to change the working conditions (the company needed to treat its employees uniformly) than on the degree to which the conditions were less favorable to the worker. This approach can be interpreted as reflecting the case-specific circumstance that the employer had been absorbed by another company (and this made it necessary to adopt the uniform working conditions).

Furthermore, the court denied the reasonable grounds for X's expectation for the contract renewal under the same working conditions as the previous conditions, on the basis of the facts that: the working conditions for Company A's re-employed workers were not uniformly determined in advance and supposed to be decided on a case-by-case basis; X knew that Company A would be absorbed by Company Y and therefore X was aware that working conditions might change; and all of Company Y's re-employed retirees concluded contracts under the same working conditions as those offered to X. Thus, the court determined whether there were reasonable grounds for the worker's expectation of the contract renewal under the same working conditions as previous contract, within the framework for determining whether the employer's refusal to renew



the contract was supported by objectively reasonable grounds and deemed appropriate in general societal terms. This constitutes a distinctive feature of this judgment when compared with existing precedents.

An employer's refusal to renew the contract with a proposal of changes in the working conditions is subject to the two-stage review under Article 19, item (ii) of the LCA, as with the case of an employer's refusal without such a proposal. Also, Article 19 of the LCA stipulates that the contract is deemed to have been renewed under the same working conditions as the previous conditions if the employer's refusal of the contract renewal is judged to be unlawful. In the present case, the court held that

X had a reasonable expectation of the contract renewal, but acknowledged the reasonableness of the working conditions presented to X in the process of determining whether X's contract should be deemed to have been renewed under the same working conditions as the previous conditions, and concluded that Company Y's refusal of the contract renewal is supported by objectively reasonable grounds and is appropriate in general societal terms. In order to draw a conclusion that is consistent with such legal effect, the reasonableness of changes in the working conditions would have important implications in determining the legality of the employer's refusal of the contract renewal.

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