

# Termination of Employment Relationships in Japan

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This article provides an outline of the main reasons for the termination of employment relationships in Japan from a legal perspective, focusing on resignation, termination of employment contracts by mutual consent, dismissal, non-renewal of fixed-term contracts, and the mandatory retirement age system.

## I. Resignation

“Resignation” refers to an employee’s unilateral notification to their employer of the termination of an employment contract. It is regulated by the Civil Code rather than by the regulations of labor law.

According to Article 627 of the Civil Code, when the employment contract does not specify the term of employment, the termination of employment shall take effect when two weeks have passed from the day on which either party to the contract notifies the other party of the intention to terminate (Civil Code, art. 627(1)). The employer is not permitted to extend the notice period to a period longer than two weeks, due to the provisions of the Labor Standards Act (art. 5, Prohibition of Forced Labor) and the freedom to choose an occupation (Constitution, art. 22). Systems under which a company’s approval is required for an employee’s resignation also have no legal force as they restrict the freedom of employees to resign (e.g., *Takano Meriyasu* case, Tokyo District Court, Oct. 29, 1976; 841 *Hanrei Jiho* 102). On the other hand, although rare, there is a case where an employee who has resigned may face liability to provide damages to his/her employer (such as when the employee has resigned suddenly [four days after starting work at

the employing company]; *K’s International* case, Tokyo District Court, Sept. 30, 1992; 616 *Rodo Hanrei* 10).

In the event that remuneration is specified with reference to a time period, it is possible for the employer to give a notice of termination of the employment contract with respect to the next time period or later, provided that the notice is given within the first half of the current period (Civil Code, art. 627(2)). Moreover, when remuneration is specified with reference to a period of six months or more, the employer must give such notice at least three months before the termination of employment (para. 3). In the case of employees who receive annual salaries, the regulations set out in paragraphs 2 and 3 of that Article may be excessively restrictive at the time of resignation. Therefore, termination notifications made by employees to their employers are subject to the general principle of two weeks’ notice as set out in paragraph 1 of that Article.

On the other hand, in the case of fixed-term employment contracts, the general principle is for the contract to terminate when the term of employment expires. When a fixed-term contract has been implicitly renewed by the parties concerned after the expiration of the original period of the contract, from the point of renewal onward, the employee may terminate the contract with two weeks’ notice (art. 629(1)).

Article 14 of the Labor Standards Act prescribes the maximum length of contract periods as three years as a general rule, and five years for contracts concluded with (a) employees with expert knowledge, and (b) employees aged 60 or older. However, Article

137 of the Labor Standards Act stipulates that, with respect to the contracts pertaining to the completion of a certain business lasting more than one year and to the contract categorized as (a) and (b) above, employees may resign by notifying their employer at any point after one year has passed, thereby guaranteeing the employees' right to resign.

The Civil Code addresses relatively long contract periods by specifying that, where the contract period is for a long period, such as over five years, the parties concerned may terminate the contract after five years have passed (article 626(1)). In such cases, a termination notification must be made by the employer three months in advance or by the employee two weeks in advance, respectively (para. 2).

## II. Termination of employment contracts by mutual consent

“Termination of an employment contract by mutual consent” refers to a mutual consent by an employee and their employer to terminate the employment contract. Such an agreement normally takes effect once the employee has manifested to the employer their intention to resign from the company and the employer—in particular, a person with the authority to approve the resignation—manifests their approval of the resignation (*Okuma Machinery Works* case, Supreme Court, Third Petty Bench, Sept. 18, 1987; 504 *Rodo Hanrei* 6; the person of authority in this case was the head of the personnel department). However, termination of an employment contract by mutual consent is recognized as having taken effect even in such a case where the proprietor of the company by which the employee was originally employed has established a temporary staffing agency and an agreement has been formed that the employee will thereafter work under an employment contract with that temporary staffing agency (e.g., *Nikken Sekkei Ltd.* case, Osaka District Court, Feb. 18, 2005; 897 *Rodo Hanrei* 91). In contrast, even where the employee is working on the establishment that they will resign—and hand over their duties while preparing to leave the company for a new job—termination of the contract by mutual consent

cannot be said to have taken effect if no official written confirmation of the resignation has been exchanged (*FreeBit* case, Tokyo District Court, Feb. 28, 2007; 948 *Rodo Hanrei* 90). In other words, for termination by mutual consent to be recognized, a substantive meeting of the minds between the employee and the employer needs to be established based on the totality of the circumstances.

## III. Precedents related to resignation and termination of contracts by mutual consent

### A. Lack or error of manifestation of intention

An employee's manifestation of intention to resign must be the employee's true intention. In the eyes of the law, cases where it is not the employee's real intention are managed under the Civil Code as issues of mental reservation (concealment of true intention), mistakes, or duress.

“Mental reservation” (concealment of true intention) refers to cases such as cases where an employee submits a letter of resignation despite having no intention to resign from the company, and the employer is aware that the employee in fact has no intention to resign from the company (*Showa Women's University* case, Tokyo District Court, Feb. 6, 1992; 610 *Rodo Hanrei* 72). Such manifestation of intention is null and void (Civil Code, proviso to art. 93(1)).

“Mistakes” refers to cases in which, for instance, an employee has submitted a letter of resignation because they wrongly assumed that they would be dismissed and were attempting to avoid that dismissal, but there was in fact no possibility of them being dismissed (e.g., *Showa Electric Wire and Cable* case, Yokohama District Court, Kawasaki Branch, May 28, 2004; 878 *Rodo Hanrei* 40). Such manifestation of intention may be revoked (Civil Code, art. 95(1)).

“Duress” refers to cases in which, for example, an employee has been compelled to resign as the employer has hinted that the employee will be subject to disciplinary action or disadvantageous treatment (e.g., *Nishimura* case, Osaka District Court, Oct. 17, 1986; 486 *Rodo Hanrei* 83). Such manifestation of

intention may be revoked (Civil Code, art. 96(1)).

### **B. Encouragement to resign**

There are some cases in which an employer may encourage an employee to resign, but it is illegal to repeatedly and persistently recommend to an employee that the employee resign in such a way that they are almost obliged to, and the person who encouraged the resignation and the employer may be liable to pay damages (*Shimonoseki Commercial High School* case, Supreme Court, First Petty Bench, Jul. 10, 1980; 345 *Rodo Hanrei* 20).

Using grounds such as gender or union activities as the basis for encouraging a resignation is, of course, illegal, as it is in violation of the Act on Equal Opportunity and Treatment between Men and Women in Employment (Equal Employment Opportunity Act) or the Labor Union Act. It is also illegal to set different eligibility ages for men and women when encouraging resignation (*Tottori Prefectural Teaching Staff* case, Tottori District Court, Dec. 4, 1986; 486 *Rodo Hanrei* 53). Encouraging or coercing a woman to resign on the grounds of pregnancy also renders the company liable to pay damages, given that it is illegal behavior in violation of the objectives of the Equal Employment Opportunity Act (*Imagawa Gakuen Konomi Kindergarten* case, Osaka District Court, Sakai Branch, Mar. 13, 2002; 828 *Rodo Hanrei* 59). Furthermore, going beyond encouraging and thereby coercing an employee to resign is, of course, an illegal act. This includes such cases as coercing an employee to resign in a way that constitutes defamation of character, due to the use of particularly derogatory expressions in a public setting (*Tokyo Women's Medical University [Coerced Resignation]* case, Tokyo District Court, Jul. 15, 2003; 865 *Rodo Hanrei* 57), or hinting at disciplinary dismissal such that an employee is pressured to choose between resigning of their own accord or putting up with being demoted, taking a pay cut, or being transferred to a different position (*Gunma-cho [Coerced Resignation]* case, Maebashi District Court, Nov. 26, 2004; 887 *Rodo Hanrei* 84).

### **C. Early retirement (incentive) systems**

Systems to encourage retirement earlier than the normal mandatory retirement age by incorporating more financially favorable treatment are known as “early retirement incentive systems.” among other such names.

As early retirement incentive systems are temporary measures for employment adjustment, they are not specifically applied unless an employee fulfils certain qualification requirements and applies for the system within a certain period, or unless the system applies automatically. However, even for employees not originally eligible due to their age, the system may apply if the employment regulations (or contract) provide for its application mutatis mutandis to other age groups (*Asahi Advertising* case, Osaka High Court, Apr. 27, 1999; 774 *Rodo Hanrei* 83).

## **IV. 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, it allows the employer to dissolve the employment relationship through a unilateral declaration of intent. Therefore, the Labor Standards Act and Labor Contracts Act contain provisions designed to protect employees.

### **A. General**

The Labor Standards Act prohibits dismissals during periods of absence from work due to injury or illness suffered in the course of employment and within 30 days thereafter, and during periods of absence from work by women before and after childbirth and within 30 days thereafter (art. 19). However, it does not prohibit dismissal as such. Furthermore, statutes prohibit discriminatory or retaliatory dismissals on specific grounds, such as gender or union activities (such statutes include the Labor Standards Act (art. 3 and art. 104(2)), the Equal Employment Opportunity Act (art. 6, item 4, and art. 9), the Act on Childcare Leave, Caregiver Leave, and Other Measures for the Welfare of

Workers Caring for Children or Other Family Members (art. 10 and 16), and the Labor Union Act (art. 7).

On the other hand, 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 ranyo hori*). This theory, which is for screening and restricting an employer’s exercise of the right to dismiss an employee (manifestation of the intention to dismiss an employee), was established by Supreme Court rulings in the mid-1970s (*Nihon Shokuen Seizo Co.* case, Supreme Court, Second Petty Bench, Apr. 25, 1975; 29 *Minshu* [Supreme Court civil cases reports] 456; and *Kochi Hosoo Co.* case, Supreme Court, Second Petty Bench, Jan. 31, 1977; 268 *Rodo Hanrei* 17).

The Supreme Court formulated the doctrine of “abusive of the right to dismissal” theory, stating that “the exercise of an employer’s right of dismissal shall be null and void as an abuse of right if it lacks objectively reasonable grounds and cannot be deemed appropriate by general societal terms” (*Nihon Shokuen Seizo Co.* case, 1975). The Supreme Court further presented a specific method for applying this theory, declaring that “even when grounds for ordinary dismissal exist, an employer may not always exercise the right to dismiss; where, under the specific circumstances of the case, the dismissal is significantly unreasonable and cannot be approved as appropriate by general societal terms, the manifestation of the intention to dismiss shall be null and void as an abuse of the right of dismissal” (*Kochi Hosoo Co.* case, 1977).

This theory has been put into statutory form under Article 16 of the Labor Contracts Act (“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 rights and is invalid”). The background to this codification was the recognition that, although the theory was regarded as the case law established by the Supreme Court but was not a statutory law and, therefore, lacked clarity for society, 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 incorporate the theory in the statutory law in order to put a stop to irresponsible dismissals in recession periods.

Legal remedies for a dispute on a dismissal include the determination of invalidation of the dismissal and payment of lost wages (the wages the employee should have earned) during the period of dispute and may also include compensation for damage in some cases. In the event that a dismissal is determined null and void, as a general rule, this would, in legal terms, lead to the reinstatement of the employee, but in reality, the employee is unable to return to their job in many cases. Accordingly, in Japan, the introduction of a financial compensation system for dismissal disputes, similar to those in force in Europe and the United States, is being discussed as a labor policy issue.

## **B. Collective/Economic dismissals**

In Japan, employment adjustment is largely implemented by reducing overtime hours or using other means without dismissing regular employees. Companies have tried as far as possible to avoid dismissing regular employees unless the business is in particularly severe difficulty. This is due to the fact that Japanese companies place importance on long-term continuous employment, and the fact that the “abuse of the right to dismiss” theory mentioned above 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 hori*) has been formed on the basis of precedents from the lower courts (as pioneering cases: *Omura Nogami* case, Nagasaki District Court Omura Branch, Dec. 24, 1975; 242 *Rodo Hanrei* 14; and *Toyo Sanso* case, Tokyo High Court, Oct. 29, 1979; 30 *Rominshu* [Labor civil cases reports] 1002). This theory was derived from the “abuse of the right to dismiss” theory.

Under the “collective/economic dismissal”

theory, judgments 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 implementing *shukko* (making temporary transfers to another company while maintaining the employment relationship with the original company), suspension of new hiring, temporarily closure, 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, their record of conduct infringing on 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 and method by which it would be carried out, etc., and then engaged in discussions with the employees or the labor union, listening to their opinions and making an effort to secure employees’ understanding.

This method of judgment, based on the “four criteria,” is thought to have been developed on the basis of the employment adjustment practices of Japanese companies. The reason this theory demands concrete grounds for dismissal according to multiple criteria—unlike the case of dismissals in general, which result from factors such as a lack of ability on the part of the employee—is likely because collective/economic dismissals only arise from the financial circumstances of the employer.

## V. Non-renewal of a fixed-term contract (employer’s refusal to renew a fixed-term contract)

A fixed-term employment contract naturally

terminates upon the expiration of its term. But there are also cases in which the contract relationship is continued or repeatedly renewed beyond the agreed term. If a fixed-term contract is renewed repeatedly, the situation may in effect resemble an open-ended contract, but under contract law, it is still a fixed-term contract. Moreover, as it is non-regular employees that are employed under fixed-term contracts, there is a greater tendency for these employees to be the target of employment adjustment, in comparison with regular employees, whose dismissal is strictly restricted under the “abuse of the right to dismiss” theory. Such termination of the employment contract relationship due to the expiration of the contract term is known as *yatoidome* (employer’s refusal to renew a fixed-term contract).

There are two main types of fixed-term contract where the employer’s refusal to renew the contract is addressed as a problem in the court: (i) cases in which the employee under a fixed-term contract 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 been conducted appropriately; (ii) cases in which the contract term is clearly defined, and the contract renewal procedures have been appropriately conducted, but the employee has a reason to expect their employment to be continued.

In addressing the employer’s 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, and have determined that the original contract relationship remains in place (as type (i), *Toshiba Yanagimachi Factory* case, Supreme Court, First Petty Bench, Jul. 22, 1974; 28 *Minshu* 927; as type (ii), *Hitachi Medico* case, Supreme Court, First Petty Bench, Dec. 4, 1986; 486 *Rodo Hanrei* 6). The theory of refusal to renew the fixed-term contract (*yatoidome hori*) is currently codified in Article 19 of the Labor Contracts Act (Consequently, under existing laws and regulations, the theory is no longer applied as an analogy of the “abuse of the

right to dismiss” theory).

There is also the issue of whether it is acceptable to terminate a fixed-term contract before the expiration of the contract term. Article 628 of the Civil Code permits the immediate termination of the contract by either of the parties involved in cases where there are unavoidable reasons. If the unavoidable reasons have arisen due to the negligence of either of the parties, that party shall be liable to the other party for damages. However, it is not necessarily clear from the relevant provisions of the Civil Code as to whether it is possible to terminate a fixed-term contract before the expiration of the contract term if there are no unavoidable reasons for doing so. Therefore, Article 17(1) of the Labor Contracts Act prescribes that, in regard to the termination of a fixed-term contract by an employer, “an Employer may not dismiss an Employee 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. Under the Act, “unavoidable circumstances” are interpreted as grave circumstances that may invalidate the specification of the term within the contract. Possible examples of this are difficulty in continuing to operate the business on the part of the employer, and the difficulty to perform work, or severe non-fulfillment of obligations or illegal conduct on the part of the employee.

## **VI. Mandatory retirement age system**

### **1. Significance of the mandatory retirement age system**

In Japan, many companies adopt the mandatory retirement age system under which employees leave employment upon reaching a certain age. The major purposes of this system may include optimizing the composition of the internal labor force of companies and enabling companies to secure a stable workforce, while providing employees with employment security and guaranteeing their seniority-based wages. As factors, such as the declining birthrate and aging population, as well as the declining working

population, have necessitated raising the age from which pensions are paid, labor policies have been set out to ensure the establishment of legal provisions that prescribe possible mandatory retirement ages and measures for extending employment after reaching the mandatory retirement age.

### **2. The legal treatment and actual state of the mandatory retirement age**

The Act on Employment Security of Elderly Persons prescribes that employers must not set the mandatory retirement age below 60 years of age (art. 8). This provision is also interpreted as a mandatory rule under private law, so that a mandatory retirement age under 60 is considered null and void. Moreover, the Act makes it an obligation for employers that set a mandatory retirement age under 65 to take measures to secure stable employment for employees until the age of 65 (art. 9). More specifically, there are three measures: (i) raising the mandatory retirement age; (ii) introducing a continued employment system; and (iii) abolishing the mandatory retirement age. These measures are obligations under public law and are not considered mandatory under private law (however, companies that have failed to fulfill these obligations are to be subject to administrative action, such as giving guidance or advice, issuing a recommendation, and publishing the failure to follow the recommendation; art. 10). In the case of above-mentioned measure (ii), current law specifies that continued employment must be offered to all employees, and employers are not permitted to screen those who opt for it. It is also prescribed that, for employers that have an affiliated company, continued employment at such an affiliated company also falls under such a continued employment system as set out in measure (ii). The Act further provides that employers must endeavor to secure stable employment for employees until the age of 70 by taking measures equivalent to those mentioned in (i) to (iii) above (art. 10-2).

### **3. The legal nature of the mandatory retirement age system and recent forms of disputes**

The mandatory retirement age system prescribes

retirement upon reaching a certain age. It is not a provision of an employment contract determining the duration of employment but is considered as a special agreement prescribing the grounds for terminating an employment contract relationship. Because the mandatory retirement age system terminates an employment contract relationship on the basis of age, its legality has been the topic of debate over the years. Among the theories, some argue that the mandatory retirement age violates public policy (Civil Code, art. 90), making it null and void. However, Japan's long-term continuous employment system is centered on the practice of seniority-based positions and wages, and the mandatory retirement age system is generally considered to be reasonable, given its capacity to provide employment security up until a certain age and allow for internal labor force reshuffles. Court rulings have also judged the mandatory retirement age system to be legitimately valid (*RF Radio Nippon* case, Tokyo High Court, Aug. 8, 1996; 701 *Rodo Hanrei* 12).

In recent years, legal disputes have arisen regarding continued employment or re-employment.

In the *Tsuda Electric Meters* case (Supreme Court, First Petty Bench, Nov. 29, 2012; 1064 *Rodo Hanrei* 13), an employee who fulfilled the criteria for the continued employment system was notified of the termination of his contract on the basis of the expiry of his one-year contract period as *shokutaku* (workers re-employed after reaching mandatory retirement). In response, the employee asserted his right to remain in employment beyond that point. By applying the "refusal to renew a fixed-term contract" theory mentioned above, the Supreme Court judged it reasonable to consider that an employment relationship equivalent to re-employment continued to exist.

In the *Toyota Motor* case (Nagoya High Court, Sept. 28, 2016; 1146 *Rodo Hanrei* 22), the court accepted an employee's claim for payment of damages on the basis of an illegal act (tort) by the employer. In this case, as a matter of generality, the court held that offering terms and conditions of employment for re-employment that are markedly lower in comparison with the prior employment is a

violation of the objectives of the Act on Employment Security of Elderly Persons (in effect, as the wage level was such that it guaranteed approximately 85% of the pension payment, it was deemed not to be a violation of the objectives of the Act). In addition, the court determined that, although in the case of re-employment, it is permitted to provide work duties that differ from those pursued prior to mandatory retirement, in the event that the work is of a different nature, such as work that entails a completely different type of duties, the re-employment is effectively considered to be regular dismissal and new hiring, lacking substance as continued employment, and therefore that providing such different work duties is not permitted unless there are grounds for justifying regular dismissal, such as lack of competence in the prior job type (in this case, the employee had previously been engaged in clerical work but was offered cleaning work on re-employment). Ultimately, the court approved the payment of damages (consolation money) to the plaintiff employee for the sum of the amount that he would have received if he had been re-employed for one year as a part-time employee. The judgment was reached on the basis that the work offered at the point of re-employment did not qualify as an opportunity for continued employment and was clearly an illegal act against the gist of the objectives of the Act on Employment Security of Elderly Persons, meaning that it constituted both a failure to meet the obligations of the employment contract and an illegal act.

In the *Kyushu Sozai* case (Fukuoka High Court, Sept. 7, 2017; 1167 *Rodo Hanrei* 49), the court held that no reasonable grounds can be found in the employer's proposal to its retired employee to conclude a contract for re-employment as *shokutaku*, which offered a wage that was 75% lower than the amount of salary paid at the time of mandatory retirement by reason of the reduced working hours for employees re-employed after mandatory retirement. The court stated that such proposal is contrary to the objectives of the Act on Employment Security of Elderly Persons and granted the plaintiff's claim for consolation money on the basis of a tort.

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