西村あさひ法律事務所

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Cross Border Newsletter

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DISMISSAL OF EMPLOYEES UNDER JAPANESE EMPLOYMENT LAW

I. Introduction

In light of the current economic landscape, we are often asked by our foreign corporate client to assist it in a plan to dismiss employees of its Japanese subsidiary or branch. However, utmost caution should be taken in carrying out such a plan, since Japanese employment law imposes rigid restrictions on an employer's right to dismiss its employees. This newsletter outlines rules and regulations on dismissal of employees under Japanese employment law.

II. General rules under Japanese employment law

The Labor Standards Act of Japan (Law No. 49 of 1947, as amended), as a general rule, only requires 30-days' prior notice for an employer to dismiss an employee (or payment of 30 days' average wages in lieu of such notice) (Article 20). However, in practice, it is generally very difficult in Japan to discharge employees once they are hired on a non-temporary basis given the firmly established judicial precedents of Japanese courts that restrict the rights of employers to dismiss their employees. This is because traditional lifetime employment practices are still considered to be prevailing in Japan, and the sole source of a worker's living is generally his or her employment. Therefore, a worker's welfare is easily jeopardized by dismissal because it would be difficult for him/her to find a new job in the current labor market.

The Supreme Court of Japan has declared in a leading case that "even when an employer exercises its right of dismissal, it will be void as an abuse of rights if it is not based on objectively reasonable grounds that are socially acceptable" (Judgment of April 25, 1975, Supreme Court, 29-4 *Minshu* 456). The Court has further held that, even where there existed grounds for dismissal provided for in the employer's Rules of Employment, "the employer is not always entitled to dismiss the employee, and the notice of dismissal will be void as an abuse of rights if dismissing the employee is grossly unreasonable and socially unacceptable under the specific circumstances" (Judgment of January 31, 1977, Supreme Court, 268 *Rohan* 17).

Reasonable grounds for dismissal, according to case law, can be generally summarized as follows:

(a) Employee's incompetence, or lack or loss of the skills or qualifications required for his/her job (e.g., exceptionally unsatisfactory job performance ratings, the loss of occupational ability resulting from an injury or sickness);

(b) Breach of disciplinary rules; or

(c) Business necessity of the company: in this category fall dismissals as a result of rationalization and reduction of the number of employees due to a business downturn.

The reasons for a dismissal generally must be so serious that the employer cannot be expected to maintain the employment relationship with the employee. Please note that, even in a case of dismissal, an employer will be required to pay the retirement allowance to the employee in accordance with the relevant provisions in the employment agreement or the Retirement Allowance Rules, if any, unless the employee is dismissed for disciplinary reasons.

In connection with (c) above, the courts have established the following four requirements for dismissal due to rationalization or adjustment of the size of the work force (the "Four Requirements for Work Force Reduction"):

(a) A compelling need exists to reduce the number of employees, e.g., serious economic depression;

(b) Dismissal is unavoidable in attaining the necessary personnel reduction: an employer must endeavor to avoid dismissal by resorting to other measures including transfers, secondments to other companies and temporary layoffs. Less painful measures than dismissal, such as solicitation of voluntary resignation, should be

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implemented prior to unilateral dismissal;

(c) The selection of the person(s) to be dismissed must be based on objective standards; and

(d) Proper procedures must be followed: this includes explaining to the workers the need for the dismissal and the conditions thereof, and consulting with them in good faith.

Based upon the foregoing, the employer is required to show that it has taken every measure to avoid dismissal even in scaling down the business. It should be noted in relation to requirement (b) above that a lay-off is recognized neither by statute nor practice in Japan and that, where adjustment dismissals (i.e., designated dismissals) have been carried out without any effort to take other measures such as transfers or solicitations of voluntary retirement, they will always be held to be abuses of the right of dismissal on an employer's part. Even in a case of total closure, due process (including prior explanation and consideration of the time reasonably required for employees to find a new job) will still be necessary.

Recently, the Act expressly incorporated the concept of an employer's "abuse of its right to dismiss" that had been recognized and developed by judicial precedents (Article 18-2 before its 2007 amendment). When the Labor Contract Act of Japan (Law No. 128 of 2007) (the "Labor Contract Act") was enacted, Article 18-2 of the Act was abolished, but the same concept of an employer's "abuse of its right to dismiss" was instead expressly incorporated into the Labor Contract Act (Article 16). The Labor Contract Act came into effect on March 1, 2008.

III. Possible consequences of unlawful dismissal

(i) Potential litigation

If a dismissal is adjudicated to be unlawful, the possible consequences are as follows:

(a) Restoration of the status of the relevant employee as an employee of the employer:

Although most cases are settled by paying monetary compensation, there have been cases in which the court actually orders the employer to re-hire the employee.

(b) Payment of unpaid wages (with default interest) from the time of the attempted dismissal until the restoration of status: the amount of any eventual income earned by the employee while the litigation was pending will be deducted from the payment by the employer with respect to the portion of the earned income that exceeds 60% of the average wages of the employee (i.e., the employer will be required to pay at least 60% of the average wages regardless of any temporary income earned by the dismissed employee).[i]

(ii) Other possibilities

The most common course of action by an employee who is dismissed is either (i) to file for a provisional injunction order for the provisional restoration of status and provisional payment of wages, or (ii) to join a labor union (the unions being fairly flexible in regard to such new memberships), which will then necessitate the employer to engage in collective bargaining for withdrawal of the proposed dismissal or any payment of compensation.

In either case, the most common solution is to settle by paying compensation either as a lump sum or in a small number of installments. As to the amount of such compensation, see below.

IV. Possible terms of settlement

Where a dispute over dismissal is settled either in or out of court by monetary compensation and the termination of the employment relationship, the amount of compensation paid for the settlement will obviously depend on the specific circumstances of the case. Although retirement allowances payable to employees leaving the company are in many cases provided for in the Rules of Employment (especially in the Retirement Allowance Rules as part thereof) depending upon the number of their respective years of services, there are no standard terms in Japan regarding severances payable in addition to such retirement allowances. The employer may provide the employee with additional compensation on a case-by-case basis in order to avoid a challenge by the employee. The main purpose of such compensation is to secure the employee's livelihood until re-employment by another company. Thus, the offer by an employer of outplacement support in conjunction with additional compensation would certainly expedite the negotiations with the relevant candidate employees.

The amount of compensation would primarily depend on how strong a case the employer would have if it litigates the case until a final judgment. If the employer has a relatively strong case, an offer of an amount equivalent to a few months' wages, in addition to the amount in lieu of notice and any pre-determined retirement allowances, would seem to be a reasonable offer for avoiding litigation. There is more room for

negotiation if the reason for dismissal could possibly constitute grounds for disciplinary dismissal, because disciplinary dismissal will deprive the employee of the entitlement to retirement allowances, as well as entail disadvantages in finding a new job. We should check whether this is the case with any relevant employees. In cases in which the justifiable reason for dismissal is uncertain or dubious, in light of the court's general stance in favor of the employee, an amount equivalent to six months' to one year's wages could well be required to settle the case.

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[i] Judgments of the Supreme Court, July 20, 1962 and April 2, 1987.

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