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Fixed-Term Employees Begin Becoming Eligible to Apply for Indefinite Term Contracts from 1 April 2018

Several developments in relation to fixed-term employment contracts in recent years require appropriate responses by companies. It has become particularly important for companies to carefully assess the risks and take necessary action in relation to (i) conversion of fixed-term employment contracts to indefinite term contracts and (ii) working conditions for fixed-term employees. Please see the below for further details on developments and suggested actions.

I. Conversion of Fixed-Term Employment Contracts to Indefinite Term Contracts

An amendment to the Labor Contract Act ("LCA") came into force on 1 April 2013 which introduced, among other things, a provision entitling an employee on a fixed-term contract who has been continuously employed by one employer for a total of five years or more to apply for an indefinite term employment contract.

An employee will be entitled to apply for conversion of his/her fixed-term contract to an indefinite term contract from the first day of the fixed-term contract wherein the term will result in continuous employment with the same employer for more than five years. The conversion to an indefinite term contract will take place upon the expiry of said fixed-term contract.

This five-year period begins to run for fixed-term contracts concluded on and after 1 April 2013. For a fixed-term employee who began working at a company before 1 April 2013, this five-year period runs from the date the fixed-term contract was first renewed after 1 April 2013. Therefore, fixed-term employees will begin becoming eligible to apply for indefinite term contracts from 1 April 2018.

Companies employing fixed-term employees will need to take the following steps to prepare for the conversion of fixed-term contracts to indefinite term contracts in response to employee requests.

Suggested actions

Step 1: Ascertain the current situation.

Companies need to assess their current fixed-term employment situations, specifically: (i) the current number of fixed-term employees; (ii) when they will be entitled to apply for conversion; and (iii) what jobs they perform. Companies should then consider the terms and conditions of employment for converted employees.

If a company does not want its fixed-term employees to gain the right to convert to indefinite term contracts, it may consider declining to renew fixed-term employment contracts to prevent the employees from reaching five years of continuous employment. However, the LCA provides that in the following cases, refusing to renew a fixed-term employment contract constitutes an abuse of

right and is invalid unless the company establishes objectively reasonable reasons for the non-renewal.

Where the fixed-term employment contract has been repeatedly renewed in the past, and it is found that refusing to renew the fixed-term employment contract upon its expiration would be, in a general social context, equivalent to unilaterally terminating an indefinite term contract.

Where it is found that reasonable grounds exist upon which the fixed-term employee would expect his/her fixed-term employment contract to be renewed upon its expiration.

Accordingly, a company must carefully consider the risks of not renewing a fixed-term employment contract to prevent an employee from reaching a five-year period of continuous employment. If a risk exists of employees challenging the non-renewal of their fixed-term employment contracts, it would be safer for the company to obtain the employees' individual consent to the non-renewal, possibly by offering severance packages.

Step 2: Consider the terms and conditions of employment for converted employees.

An employee hired under a fixed-term employment contract who converts to an indefinite term contract may be treated in one of the following three ways.

The employee's terms and conditions of employment may remain the same as those under his/her current fixed-term employment except for the contract term.

The employee may be classified under the newly established "Limited Regular Employee" category, and subject to different terms and conditions of employment.

The employee may be treated identically to regular employees.

Companies may determine the treatment of fixed-term employees when converting them to permanent employees. It is possible to treat them differently by, for example, applying (iii) above to high performing fixed-term employees while applying (i) or (ii) to low/average performers.

Step 3: Revise the work rules.

Once a company determines how fixed-term employees converted to indefinite term contracts will be treated, it will need to revise the current work rules and/or establish separate work rules for the converted employees.

For example, if a company decides to treat converted employees differently than regular employees, it will need to ensure that the current work rules for regular employees, including the retirement allowance rules, exclude fixed-term employees and employees whose contracts are converted from fixed-term to indefinite term. Furthermore, the company will need to prepare separate work rules applicable only to employees whose contracts are converted from fixed-term to indefinite term.

II. Working Conditions for Fixed-Term Employees

1. Current legal framework

Article 20 of the LCA provides that differences between the working conditions for fixed-term and regular employees must not be unreasonable in light of the following.

(i) Details of employees' duties and scope of their responsibilities ("details of duties, etc.")

(ii) The extent of any changes in the details of duties, etc. and/or working locations

(iii) Any other circumstances

Article 8 of the Part-Time Employment Act imposes the above restrictions on differences in working conditions between full- and part-time employees, while Article 9 prohibits a company from treating certain part-time employees differently than regular employees in terms of the determination of wages, provision of education and training, use of welfare facilities, and other kinds of treatment.

2. Recent Cases

Two prominent 2016 court cases which addressed Article 20 of the LCA are summarized below. Generally, courts tend to carefully assess "reasonableness" in light of the three factors above for each working condition at issue to decide whether differences in working conditions are justified.

(1) Nagasawa-Unyu decision

In this case, a regular, full-time employee was rehired as a fixed-term employee upon reaching the mandatory retirement age. The Tokyo District Court stated that where the factors in 1.(i) and (ii) above remain the same before and after rehiring, the application of different working conditions during regular, full-time employment and fixed-term employment should be considered unreasonable unless the circumstances are exceptional. Based on this principle, the court held that wage differences between the regular, full-time employment and the fixed term employment were unreasonable because factors (i) and (ii) were unchanged and no exceptional circumstances existed, and the company had therefore violated Article 20 of the LCA. Although it has since been argued that the employee's post-retirement age rehiring should have been considered an exceptional circumstance by the court, this decision applies to companies which have systems under which elderly employees are rehired under less-favorable working conditions where the factors under 1.(i) and (ii) above remain unchanged. As a result, the court upheld the claim that the unreasonable working conditions were invalid and that the work rules for permanent, full-time employees should apply to fixed-term employees.

(2) Hamakyorex decision

In the recent Hamakyorex decision, an employee claimed that differences in the payment of various allowances to fixed-term and regular employees were unreasonable and therefore violated Article 20 of the LCA. The court agreed and found non-payment of allowances for food, accident prevention, extra work and commutation to be unreasonable. However, the court found that non-payment of allowances for housing and perfect attendance did not violate Article 20 because these allowances were intended to promote the retention of regular, permanent employees whose work locations could be changed by the company. The decision also confirmed that Article 20 applies broadly to all working conditions and benefits and not only to the basic terms and conditions of employment. The court did not apply the work rules for permanent, full-time employees to the fixed-term employee in this case because separate work rules existed for fixed-term employees, who were explicitly excluded from the work rules for permanent, full-time employees. However, it is worth mentioning that the court confirmed the possibility of applying work rules for permanent, full-time employees to fixed-term employees in disputes related to Article 20 of the LCA unless said work rules explicitly exclude fixed-term employees.

Please note that Article 20 litigation is becoming increasingly common, requiring careful attention to the above issues.

Suggested Actions

Step 1: Analyze the risk of fixed-term employee working conditions being found unreasonable.

The criteria used to determine the unreasonableness of working conditions for fixed-term employees have been clarified to a certain extent by recent court cases. Companies should therefore utilize these criteria to carefully review terms and conditions of employment currently applied to fixed-term employees and analyze whether they unreasonably differ from those applied to permanent, full-time employees.

Step 2: Revise the work rules.

According to the recent court cases concerning Article 20 of the LCA, where a company's work rules for permanent, full-time employees explicitly exclude fixed-term employees from their application and the company has separate work rules for fixed-term employees, the work rules for permanent, full-time employees are unlikely to apply to fixed-term employees. Given this, if a risk exists that certain terms and conditions of employment for fixed-term employees may be regarded as unreasonable when compared to those of permanent, full-time employees, a company may consider amending its work rules for permanent, full-time employees to exclude fixed-term employees, and, if possible, preparing separate work rules applicable only to fixed-term employees. These actions would mitigate the risk of work rules for permanent, full-time employees being applied to fixed-term employees even where the court found certain working conditions for fixed-term employees unreasonable pursuant to Article 20 of the LCA.

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Reference – Draft Guidelines Published

The Cabinet listed improvement in the working conditions of non-regular workers (especially an "equal pay for equal work" policy) as a key area in Japan's Plan for Dynamic Engagement of All Citizens issued on 2 June 2016. The Cabinet published draft guidelines on 20 December 2016 to describe treatment gaps that would be considered unreasonable and in need of correction. The draft guidelines have not yet been finalized and will be fixed when amendments to the related laws are enacted.

Although they are not yet binding, the draft guidelines provide examples of clearly unreasonable treatment requiring improvement. Some examples of the problematic treatment described in the draft guidelines are below.

(1) Where a company bases the payment of a higher base salary to regular employee X than to fixed-term employee Y on X's greater amount of work experience, but X's work experience is not relevant to his/her current role

(2) Where the company pays a performance bonus to full-time employee X as a part of his/her base salary regardless of whether he/she achieves his/her sales target, but does not pay the performance bonus to part-time employee Y unless he/she achieves the same sales target as a full-time employee

(3) Where the company bases salary on an employee's years of service, but bases the salary of fixed-term employees only on the period after the most recent contract renewal rather than on the total period of the fixed-term employee's employment by the company

(4) Where the company does not pay a performance bonus to fixed-term or part-time employees even where their performance is equivalent to that of regular, full-time employees

(5) Where the company provides a smaller managerial position allowance to a fixed-term employee even where the fixed-term employee has the same role, title and duties as a regular, full-time employee.

(6) Where the company pays a lower night work allowance to a part-time employee even where he/she works the same night hours as a full-time employee

(7) Where the company pays a higher meal allowance to regular employees than to a fixed-term employees

(8) Where the company pays a housing allowance only to regular employees and not to fixed-term employees, although both regular and fixed-term employees can be ordered to change their work locations to any part of Japan

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