KOJIMA LAW OFFICES

Kojima Law Offices

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Labor & Employment Law Newsletter

Trouble reducing headcount in Japan? Try cutting pay instead.

INTRODUCTION

Companies with a legitimate need to cut costs in Japan face tremendous hurdles in reducing their workforce due to the country's strong pro-labor laws (this issue was covered in depth in Volumes 3-5). This is also true for employers looking to shed subpar workers. A less drastic alternative would seem to be cutting pay instead of laying people off. But is it a realistic option?

BACKGROUND

Companies seek to cut pay for two main reasons. First, companies often wish to reduce overall costs, typically through across-the-board pay cuts. Although companies can generally implement company-wide pay reductions under Japanese law, the cuts must be reasonable both in terms of size and necessity. The second reason is to implement selective pay cuts for subpar employees who fail to pull their weight. This is typically accomplished by demotions. We discuss below the requirements and limitations of both.

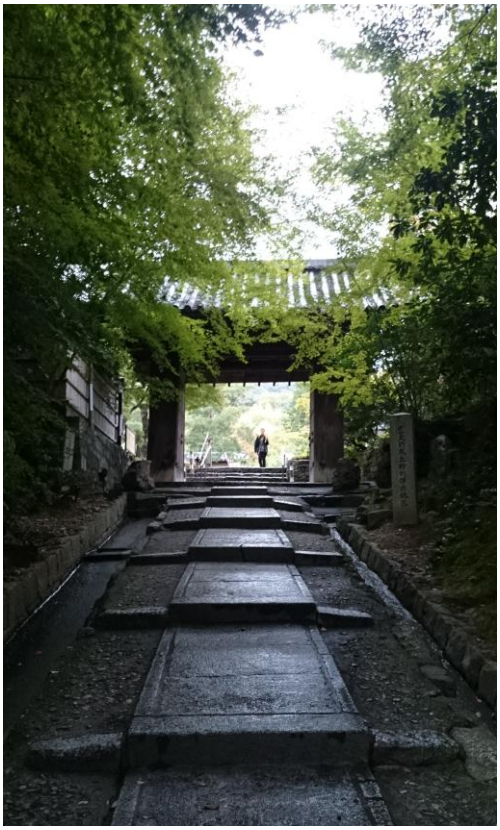
ACROSS-THE-BOARD CUTS

By having everyone share the pain, across-the-board pay cuts would seem to be an attractive option in Japan, where layoffs are both frowned upon and legally difficult. However, as with most employer actions in Japan that are detrimental to employees, the issue is typically not so clear-cut. There are three main ways to implement across-the-board pay cuts.

First, a company can obtain consent from each of its employees individually. If all agree, the company has effectively implemented an across-the-board pay cut. Even if there are a few holdouts, however, the company will still enjoy significant cost savings. Employers should ensure that the consent is in writing to avoid potential challenges down the line.

A company can also implement across-the-board-pay cuts by reaching an agreement with the union. This agreement will of course apply to the company's unionized workers but may under certain circumstances also apply to non-union members. There is a catch, however. Even agreements that are "blessed" by the union can be found invalid in whole or in part if the pay cuts end up being applied unevenly to certain employees.

The other possible way to implement across-the-board pay cuts is to revise the company's rules of employment to provide for such cuts (within certain limits, of course). The rules should also contain a reasonably detailed calculation of how the company determines the salary of its employees. For employ-



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ers that decide to go this route, the revision must:

- Not be unreasonably detrimental to the workers
- Be made to address a genuine need for cost reduction
- Be appropriate in light of the company's particular circumstances
- Take into account the status of any negotiations with the union or, if the employees are not unionized, with a representative of a majority of the employees

Passing the reasonability test requires employers to demonstrate dire financial circumstances and the necessity of pay cuts to restore the health of the company. In addition, the pay for directors and highly compensated employees should be cut first before cutting the pay of regular employees. If the cuts will instead be made all at once, the employer should consider applying deeper cuts for directors and highly compensated employees than it imposes on regular employees.

POOR PERFORMERS

It would perhaps be more appropriate to call this section "Demotions" because that's the basic mechanism of cutting the pay of poor performers. The demoted employee's pay is technically not "cut"; it is simply reduced to match the employee's new (lower) position or title. Perhaps it is this distinction that gives employers relatively broad discretion to demote subpar employees.

This discretion isn't without its limits, of course. The company's rules of employment must allow for the possibility of demotion-based pay cuts. The same goes for the company's employment agreements. Moreover, companies may find it harder to demote individuals hired for a specific job or title, at least compared to those who follow the traditional career path of being hired straight out of college and working their way up through the ranks of the company. Companies should also as specifically as possible inform at-risk employees what goals or performance targets the company expects them to achieve. By doing so, companies will have an easier time demoting employees who fail to meet these targets.

As is the case with layoffs, companies must be careful not to abuse their power as employers when conducting demotions. In this connection, the validity of a company's actions are determined by several factors, including the necessity for the demotion, the skills and experience of the affected employee in relation to his or her current position, and the impact of the demotion on the employee. As long as it's not too drastic, a pay cut that accompanies a valid demotion is generally also regarded as valid. (However, the case discussed below shows that this isn't always true.)

HOW LOW CAN YOU GO?

Regardless of the approach, there's a limit to how drastic the pay cuts can be. A review of the relevant case law does not provide absolute numbers, but the upper limit for across-the-board cuts seems to be somewhere in the range of a 10-20% reduction, while the comparable figure for subpar employees is higher, perhaps between 30-40%.

More than one case found a 20% or 30% across-the-board cut to be too high, even though the company had revised its rules of employment to allow for such cuts. The reasoning was that an across-the-board pay cut can have a drastic impact on the livelihood of many employees who may not have been responsible for the company's financial problems. In one extreme case involving a company on the brink of bankruptcy, the court allowed a 40% reduction. This case is probably an outlier, however. In practice, such large cuts are very rarely permitted.

Passing the reasonability test requires employers to demonstrate dire financial circumstances and the necessity of pay cuts to restore the health of the company.

Of course, this rationale does not apply to subpar employees, which may explain the court's greater tolerance for deeper cuts. In one case involving a poorly performing employee, the court found that a 40% cut was too high. In that case, the company demoted a manager and cut his annual pay from 11,500,000 yen to just 6,900,000 yen. Although the court found the demotion itself valid, the court deemed the pay cut too extreme. The court cited the lack of provisions in the company's rules of employment that would justify such a large cut, meaning that the company had almost unfettered discretion in this area. As a result, the employee had no way of knowing that the company could cut his pay so drastically, and did not know the basis for the cut. This leaves open the question of whether a court would allow a 40% cut that was provided for in the rules of employment, assuming the employee was fully aware that such a large pay cut was possible.

AVOID USING PAY CUTS AS RETALIATION

Although pays cuts may be valid depending on the circumstances, companies are typically not allowed to use them to pressure an employee to resign. Even if this was not the company's intention, a court could find a violation if there's an appearance of coercion. To minimize the chances of this happening, a company should cut an employee's pay prior to any suggestion or proposal that the employee resign. Reversing the order of these two steps could create the appearance of retaliation, which is prohibited.

Stress Check FAQs

INTRODUCTION

Japan has the highest suicide rate among the G7 countries, and some of those suicides are due to work-related stress. The government's own statistics show an increasing number of mental disorders caused by work such as anxiety and depression. In addition, employers are beginning to realize that healthy workers boost the company's productivity and overall business performance. For these reasons, Japan passed legislation requiring that certain companies offer their employees the opportunity to take a "Stress Check" designed to identify work-related mental health issues and address them as early and as effectively as possible. Here we answer some of the most commonly asked questions about the new Stress Check requirement.

What is a Stress Check?

Starting on December 1, 2015, companies in Japan with at least 50 employees at a given workplace will have to offer those employees the opportunity to complete an annual Stress Check questionnaire designed to ascertain their mental health. The first one needs to be conducted no later than November 30, 2016.

My company has more than 50 employees but they work in different offices across Japan. Does the Stress Check requirement apply?

Only if there are at least 50 employees working in the same location. Otherwise, no. For example, a single workplace with 50 employees would be covered under the Stress Check law, but two offices with 25 employees each would not. The Stress Check requirement would apply to the 70 employees at a company's Tokyo headquarters, but not to the 30 employees at its Nagoya office.

We have a large number of part-time and temporary workers. Are they counted for purposes of the 50-employee requirement?

Yes.

No one in my office is talking about the Stress Check or asking for a questionnaire? Does that mean we don't have to worry about it?

No. Employers are required to offer the Stress Check questionnaire to their employees even if no one requests it.

Is the Stress Check a psychological exam?

Not exactly, at least not on the employer's side. Here in a nutshell are the steps involved in a Stress Check:

- The employer first needs to retain the services of a doctor or other qualified health-care professional ("doctor") who will help the employer comply with the Stress Check requirements.
- The employer must provide its employees with the opportunity to complete a Stress Check questionnaire.
- The doctor then reviews the questionnaire at the employer's expense.
- If the results raise sufficient concerns over the employee's stress level or mental health, the doctor may recommend that the employee undergo a mental-health evaluation.
- If the employee would like to follow that recommendation, the employer is required to pay for the evaluation.

If a company has to pay for mental-health evaluations, shouldn't it be able to know why the evaluations are necessary?

Yes. The law tries to balance the needs of the company and the employees' privacy interests by permitting companies to request access to the questionnaire results. The idea is that employers who must pay for an evaluation should be able to confirm that the employee in question satisfies the eligibility requirements for that evaluation. However, if the employee doesn't request an evaluation, the questionnaire results remain strictly confidential.

Employers are required to offer the Stress Check questionnaire to their employees even if no one requests it.

Only the employee and the reviewing doctor have access to the questionnaire results (doctors disclose results directly to employees). The employer will not get a copy unless the employee consents. However, employers can obtain questionnaire results without consent if the results do not identify the employee. If they choose, companies can use these anonymous results to make improvements to the workplace.

Does the employer need to do anything else?

If the examining doctor suggests ways to improve the employee's mental health, the employer is required to take

reasonable measures to do so. These steps could include reducing the employee's scheduled working hours and overtime, limiting business trips, and lightening the employee's workload.

Will the government provide the Stress Check questionnaire?

Yes and no. The government has prepared long and short versions of a multiple-choice questionnaire that companies may use, and the majority of companies have indicated that they will use one of them. Employers are free to come up with their own questionnaires. In practice, however, there is little incentive to do so. Why? Because using the government's questionnaire ensures compliance with the Stress Check requirements. It also eliminates the burden of having to prepare one from scratch.

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My company operates in a notoriously high-pressure industry and we would like to do everything possible to protect our employees' mental health. Can we use a more detailed Stress Check questionnaire than the government's?

Yes, but the safest approach is to simply augment the government's version with additional questions.

What must the questionnaire contain?

The questionnaire needs to cover three main areas: the causes of work-related stress, the physical condition of employees suffering from work-related stress, and the level of support from coworkers.

Can employers require employees to complete the questionnaire?

No, the questionnaire is purely voluntary. This obviously means that employers are prohibited from making the questionnaire a requirement in their rules of employment. It also means that employers can't penalize employees who: (i) choose not to take part in the Stress Check; (ii) either request or refuse a mental-health evaluation based on the results of the questionnaire; or (iii) refuse to disclose the questionnaire results.

How does the government know that companies are properly conducting Stress Checks?

Employers are required to file an annual Stress Check report with the applicable labor office.

What are the consequences of non-compliance?

Failure to file the annual Stress Check report carries a maximum fine of 500,000 JPY.

This all sounds a bit complicated and messy. Can't we just outsource this?

Yes. In fact, a recent survey showed that at least 60% of employers will retain an outside company to handle all or part of their Stress Check obligations.

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