A SPECIALIST OFFERS ADVICE

More Difficult to Fire, and a Rising Mandatory Retirement Age

By Thomas J. Nevins, President, TMT Inc. (Part Two)

Last issue, our specialist contributor discussed some of the complexities that had arisen due to the fact that overtime rates had risen for many types of employees. And he offered some suggestions for how firms could re-constitute their policies and practices to keep the cost of overtime down.

This month, in the second of this two-part contribution, our contributor discusses how to work around or even re-define the firing of an employee to reduce the cost, and possible litigation, in doing so. This, while he points out how, in the case of retirement benefits, the government has in effect encouraged employers to reduce salaries and benefits for the staff that they allow to work beyond age sixty.

More Difficult to Fire When It Was Supposed to Become Easier

In the area of dismissal and employment security, a few years back, former prime minister Koizumi wanted to follow China's lead, and have Japan become more competitive by making it easier to dismiss or terminate employees in Japan.

In the statute books, it already appeared to be rather straightforward and easy to terminate in Japan. According to Article 20 of the Labor Standards Law, a person could be terminated without cause as long as thirty days notice, or thirty days pay, or a combination of the two, were given. However, in Japan, it was never that easy. If it got to court, judges came to all-too-easily rule that an employer was abusing the employee's Article 20 right of dismissal. In fact, other than the thirty days notice or thirty days pay, there were no universally accepted monetary severance standards in the statutes, based for example on years of service — such as I understand there are in countries such as Germany, Hong Kong, or Singapore. This meant that, although the judge would rarely allow an employer to terminate with the minimum legally-required thirty days notice or thirty days pay, a judge would also not firmly rule that if more severance than that, or an 'X' amount were paid, the termination would stand. Short of such an explicit ruling then, the judicial termination process became one of trying to get the parties to settle on an amount. And the greedy, stubborn party usually made out best.

In any case, Koizumi's intention to make Japan more competitive by making it more possible to terminate employees — and his proposed new law to this effect — backfired. It became even more difficult, with a footnote added to the law to the effect that reasons for termination had to be given in writing, and that there had to be a socially-justifiable standard and rational reason. In the meantime, employee fight-back on terminations using the courts has increased manyfold in recent years. Judges continue not to want to write decisions, but instead drag employers back to court until the employers are so bored and tired they will pay big settlement money just to end it all. More employees hear about this, and the spiral continues up.

What do employers need to do? Stop 'firing' *per se*. Instead, adjust Rules of Employment (ROE) language such that it allows pay adjustments for job change or lack of performance and contribution, other than the maximum legal penalty of one-half day's pay, or maximum pay cut of ten percent of monthly salary. This maximum legal pay cut is stipulated in the Labor Standards Law, and is usually interpreted as a pay reduction for discipline, or punishable infractions. Fair enough, but discipline is not usually the problem. More often, in all countries, people are fired for personality quirks, weaknesses in performance, contribution, teamwork, or an overall inability to fit in and properly do their jobs. As an employer, you need to show in your company's ROE that for certain performance and contribution reasons, not disciplinary reasons, you can reduce pay by more than ten percent on an exceptional basis. And the Labor Standards Office (LSO), and basically even the courts, will accept this. As long as an employer pays above the level of the minimum wage, the LSO will not stop it. Of course the LSO may also mention that an employee could try and get redress by way of a civil suit. However, you will be much better off in court on pay reduction litigation, than you would be on termination litigation.

If you must reduce someone's pay, in 'consideration' of this reduction, or to help ameliorate, compensate for, or avoid this pay reduction, also consider offering the employee an option of taking a modest extra severance package for, in effect, resigning (although better to call it 'separation'). Just note, that initial low-balling is dangerous. Communicate well, and do not fire with a hope and a prayer. Try to avoid telling people what is wrong with them. Give them a chance to pull their own rug out from under themselves. Give them a chance to pull away, rather than making it seem that you, the employer, are pushing them away. Then you never have to say to the person "You're fired" or any of the softer versions of that. Many people will gladly give up severance money, just to be able to go through life believing, or being able to say, that they

Continued on Page 6

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More Difficult to Fire

By Thomas J. Nevins (Part Two — Continued)

have never been fired.

Most people with family, and other responsibilities, however, will not quit too quickly and easily, unless you gingerly make it clear right up front, and at the beginning of the conversation, that if they decided to go "we take good enough care of our people under these circumstances of separation." If the person knows they will get decent severance if they quickly 'resign'/separate, they are much more willing and likely to leave quickly and without a fuss. Do not work blind and in the dark, and always get a signature on a 'separation letter' (not a 'resignation letter'). Know what you are dealing with, before you come in with a fixed-in-stone severance package and the paper work nicely completed. You will most likely get crossed arms and silence if you come in with a fixed position like that. If you try and protect your backside, by slipping into the letter that they 'resigned', most people will get angry.

The Stock Option Wrinkle

An interesting insight I gained rather recently is the additional difficulties that can accompany stock option grants. They had not been so common in Japan. In one case, a man missed an opportunity to cash in and make over $2 million if he had executed his options several years ago. When his company recently terminated him, his options were only worth about $190,000. He was probably madder at himself for not executing the options when they were worth so much. Maybe he was being tough on himself, but after he got his $190,000 for the exercising of his stock options, and an additional $30,000 in severance, he got tough with the employer, and nevertheless took that employer to court.

I was called in after it had been in court for a year. The man was cheeky enough to ask for an additional $1,750,000, a sum at which the LSO (the government office employees often go to in such cases) and the judge both laughed. This individual was annoying and resented by the judge, and before that at the LSO. We gave the judge the option to order him back to work at a lower salary. The judge went along with this. However, the judge would not and could not prevent him from further suing for an additional stock option settlement — as irrational as the dismissed individual's reasoning was on this stock option issue. Other people at the company, including my expatriate client, had also not executed their options at that juiciest moment several years back. That was a personal decision, and the fault of the individual employee holding the stock options. Most people around the world, and even in Japan, see it that way, but not this rather strange, greedy, angry, and stubborn individual.

This individual was making out well in court because he was a gambler, and also extremely stubborn — "No, No, No!" was his answer to every one of the judge's proposals and jawboning. Whether he was back in the company, or working elsewhere, the prospect of his launching a separate suit over those stock options was too distasteful for us. The way that man played the system, he would have made out well enough in a separate settlement of the stock option lawsuit; even though it was his own fault he did not exercise his options. There was, of course, no way to predict if the options would be worth alot in the future if he were to have continued to work at the company. But he just kept complaining and talking about such possibilities.

Continued on Page 7

A SPECIALIST OFFERS ADVICE

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He was a broken record, and broke us all down!!

To make a long story short, we used every trick in the book, and the judge was not a bad one, but in order to settle everything at once with this stubborn man, it cost my client an additional $330,000. (The individual was willing to settle his 'wrongful dismissal' for the ¥20 million, or $ $174,000, jawboned by the judge. However, the suing employee made it clear that he would continue to pursue damages on the stock option issue by way of a separate suit, with the judge making it clear that neither he nor the court system would or could stop such a separate suit.)

As a side note, as soon as our firm was brought into the matter, I directly asked the judge if the judge felt that the termination case would be supported with the company winning. The judge answered my question, and made it clear to me and my client, that even before proceeding with witnesses, and regardless of what witnesses testified, the judge was quite sure that in his judgment, he would not uphold the termination of this man. As I said earlier, that litigation was already at the one year point when I joined the party. The client told me that as of when I got involved, the client's law firm had already cost the client about ¥6 million ($52,000). Meanwhile, legal fees probably closed out at another $20,000 or $30,000 (although I did not want to ask the client, and do not know for sure).

The new message for me, and the lesson for all of us, I guess, is to think twice about stock options. In Japan there may be too many people who just do not get what they are all about. This may even include judges who do not want to rule on the issue, and employees who will not accept responsibility for the way they played their stock options.

But then again, judges in Japan almost never want to make a clear ruling or decision on any termination. Almost everything is done by way of a court officiated *wakai*, or settlement. This is why you need to learn the art of getting the same result without terminating, and at a much cheaper cost.

Mandatory Retirement Age On the Rise

In Japan, employers must enroll employees into the mandatory social security government retirement system. This is called *kosei nenkin* or national pension insurance. The contributions are equally made by the employer (on top of the salary amount quoted to someone joining a firm), and by the employee by way of a deduction at the time that monthly salary is paid. The employer pays 7.144 percent, and the employee has deducted from his or her monthly salary the same 7.144 percent, for a total of 14.288 percent.

In addition to this, most companies provide for a corporate retirement allowance. This is not legally required, although once the retirement plan is defined in a company's Rules of Employment (ROE), unless the company changes the benefit and those ROE, the employer would have to provide this benefit. (ROE are legally required under labor ministry jurisdiction if a firm has over ten employees. However, in practice, when a firm hires its first employee and wants to place him or her in the mandatory government social insurance plans, the social insurance office usually asks for a copy of the ROE.) Traditionally, this non-mandatory retirement benefit is paid out as a defined benefit (not a defined contribution benefit) lumpsum retirement allowance within some thirty days (or could be more) of retirement. The retirement allowance was traditionally based on months of base monthly salary times a number of months of salary depending on years of service. It was traditionally one month or a bit more of monthly salary for every year of service, and it usually is defined as it appears in a table at the back of the ROE. It usually defines the payment up to forty years of service, and it might peak at fifty months of salary for those with the longest tenure.

The *kosei nenkin*, or national pension insurance used to be payable to employees at the traditional retirement age of sixty. In recent years, the age that this is payable from the government has moved up to 65. A lot of people do not seem to know it, but from April 1, 2006 the retirement age 'basically' became 62. From April 1, 2007 it became 63, from April 1, 2010, it will become 64, and from April 1, 2013, 65 years old. I say 'basically', because in fine Japanese form, things are never quite what they may at first seem. For example, the retirement age could be kept at sixty in the Rules of Employment (ROE), as long as there are explicit written objective and fair criteria for letting most (but not necessarily all) people work up to the above ages.

The authorities recommend that years of service toward the retirement benefit be capped at age sixty, and that people be re-employed on term contracts if they work beyond that age. This testifies to the fact that the government authorities have always been mindful of the burdens and needs of companies as well as employees. If, on the one hand,

Continued on Page 8

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the government was going to force employers to keep people working longer by way of increasing the retirement age, on the other hand it (and of course the business interests that lobby the government) also felt it was too much for employers to also have to be burdened with continuing corporate retirement liabilities. Adjustments in pay level can take place, as can the work assigned. The rational is that one should work longer, but the government certainly does not want to also force employers to maintain the high pay levels of older workers who may be losing their edge.

I think firms and the authorities have always been mindful that it is necessary to make room for younger people in the ranks of managers. In this sense, age discrimination is non-existent on such an issue in Japan. So this means that although companies essentially have to allow their employees to work up until the above extended retirement ages, the non-mandatory, non-government corporate retirement benefit can be, and usually is closed out at age sixty. And the mandatory, government program of *kosei nenkin*, or National Pension Insurance, would continue to be payable by both the employer and employee, but payable at the lower salary levels employees received if salaries were lowered after age sixty. In the administrative guidance of the government, they actually recommend and assume that this is what companies will do. The government, and Labor Standard Office, also has no problem if pay levels of people are reduced at age sixty, or if the fact of reaching age sixty is the only reason for the reduction. Actually, backed up by earlier administrative guidance, many firms adjust pay levels down at an earlier point — when most employees reach age 55. This guidance was a legacy from about twenty years ago when employers were first encouraged to move the traditional 55 year old retirement age up to age sixty.

So this is a pretty reasonable approach and system that should be good for employees who cannot get the government national pension until age 65 now, and employers who can flexibly utilize older workers as the labor market tightens. And with the aging of the workforce, and decrease in population, there now is, and will continue to be, even more of a labor shortage in Japan. As wages rapidly go up in other Asian countries including China, and the Japanese realize they have been burned by transferring (knowingly or unknowingly) too much technology to places like China, manufacturing in Japan will become more attractive. Already, as noted several times by *SSJ* in earlier issues, some large plants are being built in Japan, or are slated to be built here, for example the first new auto plants in years. The frequency of this occurrence would have happened less ten, or perhaps even two years ago.

However, if a foreign capitalized firm does not know of the above flexible and widespread application of the law, and does not have the right written and practiced policies in effect, the increase in the retirement age can become much more of a labor pain than it needs to be. Our firm has seen countless clients that were not informed of these flexible applications by their local staff. So Japan may be unusual. Although the retirement age is going up above sixty, that does not mean that pay levels have to be maintained above age sixty. In fact, in most Japanese firms, a *quid pro quo* for extending employment beyond sixty is the employee's acceptance of a salary cut. And additionally, these same firms do not allow years of service beyond age sixty to be calculated into their retirement benefits.

At many foreign-capitalized firms in Japan, neither the headquarters' office nor the expatriate president in Japan may not know these things. In those cases, often local Japanese managers keep their mouths shut, and do not go out of their way to educate their companies to the possibilities that would keep those companies more competitive with what other Japanese employers are doing. I suppose the native local staff directly affected cannot be blamed for ho-ping that salaries and retirement benefits will continue to rise beyond age sixty. In fact, I believe there is nothing wrong with salaries rising for some of your people over age sixty. I also believe that people over 65 can do a good job, and at least in Japan, you do not have to worry about age discrimination when it comes to assigning them to an appropriate and fair pay level each year on those extension contracts.

But as with so much in Japan, it pays to become educated to the way labor rules are practiced by other firms, as well as to the way they're administered by government agencies and the courts. As discussed here with regard to termination practices, and in Part One with regard to overtime policies, understanding what companies have tried to do, and what has been supported by the government, is much of the battle.

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