



Overtime compensation for white-collar employees in Japan

This briefing examines a 2005 Japanese court ruling that held that overtime compensation for a white-collar worker who had broad discretion in determining his working hours and received a high salary can be considered as part of the annual salary package. It also summarises the ongoing debate on this topic and the possibility of enacting a white-collar exemption in Japan. Businesses operating in Japan should be aware of the possibility of change in this area of employment law.

Outline of the judgment

A former white-collar employee of a foreign investment bank (the 'company') lost his claim for approximately ¥8m in overtime compensation that he had claimed on the basis that he had worked in excess of the working hours provided for in the company's work rules. The Tokyo District Court dismissed the claim on 19 October 2005, concluding that overtime compensation was already included in the employee's base salary.

According to the company's work rules, the working hours for the employee were from 9am to 5.30pm (including a one-hour break). The plaintiff attended an early-morning meeting every day and claimed compensation for his attendance at this meeting.

The parties disputed, among other things:

- whether the plaintiff actually worked overtime and, if so, how many hours;
- whether the plaintiff was placed in a managerial or supervisory position (article 41, paragraph 2 of the Labour Standards Law); and
- whether the overtime compensation was included in the base salary.

The court dismissed the claim, asserting the following arguments on the last issue.

- When the plaintiff joined the company, he signed an agreement outlining his position and function, as well as his salary. The agreement did not stipulate a provision on payment of overtime compensation.

- The plaintiff did not obtain any overtime compensation while working for the company and never objected to this.
- The plaintiff earned an extremely high salary, which was not comparable to that of an ordinary employee obtaining salary and other benefits, including overtime compensation.
- The plaintiff decided his own working hours and his working routine at his own discretion and the company did not regulate his working hours.
- It is common practice that an extremely high salary paid by investment banks to white-collar employees includes compensation for overtime work and no extra payment is made for overtime work.

The court then stated that the rule established by the Supreme Court in 1988 (the *Kozato Kizai* case) did not apply to this particular case. In that case, it was held that an agreement providing that the base salary included compensation for overtime work would not violate the Labour Standards Law as long as:

- the component of the salary that is paid for overtime work is clearly distinguished from the rest of the base salary; and
- there is an agreement stipulating that if the legitimate overtime compensation calculated under the Labour Standards Law exceeds the component of the salary paid for overtime work, extra overtime remuneration will be paid.

The court stated that the purpose of article 37 of the Labour Standards Law, requiring compensation

for overtime work, is to ensure employers pay the compensation, protecting employees from excessively heavy labour. The court determined that the agreement between the plaintiff and the company was valid and consistent with that purpose for the following reasons.

- The amount of the plaintiff's salary depended on his performance and contributions to the company and thus the number of working hours did not play a decisive role.
- Since the plaintiff was allowed to decide his own working hours and his working routine at his own discretion, it was difficult for the company to ascertain his actual working hours.
- While working for the company, the plaintiff never objected that he was not receiving overtime compensation, although he was aware of it.
- Since the plaintiff was receiving an extremely high salary, he was not in need of protection.

The judgment's effects on business practice

The judgment will be good news for employers who wish to adopt an annual salary system under which the total reward shall consist of the base salary and the result-based bonus. The prevailing rule before this judgment was that an agreement providing that base salary includes compensation for overtime work would be valid only if the component of the salary paid for overtime work was clearly distinguished from the rest of the base salary. This judgment changed this rule and employers are now allowed to include the remuneration for overtime work within the base salary if:

- an agreement between the employer and the employees (such as work rules (*shugyo kisoku*)) stipulates that the base salary includes remuneration for overtime work and no extra payment will be made to compensate for overtime work;
- the employee's salary structure is determined by his performance on the job and his contribution to the company, so the number of working hours does not play a decisive role;
- the employee decides his own working hours and working routine at his own discretion; and
- the employee earns a high salary so that protection of him is legally superfluous.

There have been recent discussions in Japan over whether white-collar employees should be excluded from existing working time and compensation regulations.

In June 2005, the Japan Federation of Economic Organisation submitted a recommendation that the working hours etc of white-collar employees should be exempt from the current system (the 'white-collar exception') and in January 2006 the Ministry of Health, Labour and Welfare published a report on the white-collar exceptions in place in other countries. In 2007 the Japanese government considered submitting a bill to the Diet to enact a white-collar exemption by amending the Labour Standards Law (although it eventually declined to do so on the basis that the proposed amendment had not yet obtained public understanding). These events indicate that the issue of a white-collar exemption will continue to be discussed in Japan. The judgment has inevitably had a significant effect on the discussion, indicating that the issues may be solved to a certain extent even under the current legal system.

A subsequent judgment by the Tokyo District Court on 28 January 2008, regarding overtime compensation for a senior employee with the title of 'store manager' (*tencho*) at a McDonald's chain restaurant, focused on the issue of the definition of a 'managerial or supervisory position' because under the Labour Standards Law employees in a managerial or supervisory position are exempt from existing working time and compensation regulations. In the light of the McDonald's judgment, the Ministry of Health, Labour and Welfare issued on 9 September 2008 instructions on the definition of a managerial or supervisory position applicable to senior staff at chain retail shops and restaurants. Nevertheless, because the judgment concerned issues other than the definition of a managerial or supervisory position, the judgment is still valid as a court precedent, regardless of the conclusion in the McDonald's judgment and the instructions issued by the Ministry of Health, Labour and Welfare.

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