Restrictive covenant clauses Q&A: Japan

by Yuko Kanamaru, *Mori Hamada & Matsumoto*

Country Q&A | Law stated as at 30-Jun-2020 | Japan

Japan-specific information concerning the key legal and commercial issues to be considered when drafting restrictive covenant clauses for use in the terms of employment between the employer and employee. See *Standard clauses, Restrictive covenant clauses: International*, with country specific drafting notes and *Standard document, Terms of employment: International*.

This Q&A provides country-specific commentary and forms part of *Cross-border employment*.

Restrictive covenants

1. In your jurisdiction, can *Standard document, Restrictive covenant clauses: International* be used in the following documents:

- Terms of employment with the employee at the start of employment?
- A simple separate agreement?
- A deed?

Yes. Under the Japanese law, restrictive covenants can be used in any of the following:

- Terms of employment with the employee at the start of employment, including the rules of employment.
- A simple separate agreement.
- A deed (however, it should be noted that there is no specific concept of a "deed" under Japanese law).

© 2020 Thomson Reuters. All rights reserved.

2. Is it possible in your jurisdiction for employers to use restrictive covenants to protect their business by restricting an employee's activities for a period of time after their employment has ended?

Yes. That said, if they restrict the rights of the employees so broadly and strictly as to be deemed against public policy and morality, they will be deemed to be unlawful and void. It is advisable to minimise these restrictions to the extent genuinely necessary to protect the business and not to restrict the employee's right unfairly.

Definitions

3. Is there any definition of confidential information in your jurisdiction that is required by law or standard practice in restrictive covenants?

There is no specific definition of "confidential information" which it is standard practice to use in the context of restrictive covenants, and parties to covenants usually define the word as they see necessary.

It should be noted that, if any information falls within the definition of "trade secret" under the Unfair Competition Prevention Act (Act No.47 of 1993) (UCPA) ("a production method, sales method, or any other technical or operational information useful for business activities that is controlled as a secret and is not publicly known"), it will be protected even without executing any restrictive covenants. Therefore, it might be advisable to use a definition of "confidential information" which is broader than the definition of "trade secret" under the UCPA.

4. Is the term Group Company recognised in your jurisdiction? If so, please can you set out an appropriate definition for *Standard document, Restrictive covenant clauses: International*.

Yes, it is recognised. However, it should be noted that "group company" is not a legal term. In general, it is used to mean a company which belongs to a corporate group, including a holding company, subsidiaries and affiliates. The definition used in *Standard document, Restrictive covenant clauses: International* would be appropriate.

© 2020 Thomson Reuters. All rights reserved.

5. Are the terms subsidiary and holding company defined and recognised under the laws of your jurisdiction? If so, please can you set out an appropriate definition for *Standard document, Restrictive covenant clauses: International*.

Under the Japanese Companies Act (Act No. 86 of 2005), "subsidiary (company)" is defined as any entity which is prescribed by Ministry of Justice Order as a corporation the management of which is controlled by a company, including, but not limited to, a stock company in which a majority of all voting rights are owned by the company.

There is no definition in the Companies Act of "holding company", but this term is generally used in standard practice as meaning a company which does not conduct specific business of its own but merely holds the shares of subsidiaries and functions as the centre of the group companies.

6. In your jurisdiction, where an employer wrongfully dismisses an employee or the employee resigns in response to a repudiatory breach, is the employee released from any restrictive covenants?

No. In general, if an employee has agreed to the restrictive covenants (whatever form they take), the employee would not be released from them without the employer's agreement or waiver, even in cases of wrongful dismissal or resignation because of a repudiatory breach by the employer.

Rather, when the termination is unlawful or invalid, the employee will keep their position as an employee at that company and the restrictive covenants which apply post-termination are therefore not triggered. Please note, however, that if the employee resigns, this will not be the case and the post-termination restrictive covenants will apply.

7. If the answer to the question above is "yes" can the employer attempt to get around this by stipulating that the restrictions apply on Termination which includes in its definition "on termination howsoever caused", or "on termination whether lawful or not"? Would these be enforceable?

While the covenants (after the termination) will not come into force when the termination is unlawful or invalid (see *Question 6*), it is useful to include in the definition of "Termination" the words "on termination howsoever caused", especially when the covenants are included in the employment agreement or the rules of employment. Without the allegation by the employee, and the court's determination, that the termination is unlawful or invalid, the employment relationship will not be reinstated.

Restrictions

© 2020 Thomson Reuters. All rights reserved.

8. Are all the restrictions in *Standard document, Restrictive covenant clauses: International: clauses 2.1 (a) – (f)* recognised in your jurisdiction?

Yes. All these restrictions are recognised. The restrictive covenants can include any provision agreed voluntarily between the parties, unless it is determined to be so broad and restrictive of the rights of employees as to be against public policy or morality (for a covenant executed at the time of termination, see *Tokyo District Court judgment 24 April 2007* (*Roudou Hanrei No. 942, p. 39*); for a covenant executed at the time of employment, see *Tokyo District Court judgment 10 March 2012* (*Roudou Keizai Sokuho No. 2144, p.23*); and for a covenant included in the rules of employment, see *Osaka District Court judgment 23 October 2009* (*Roudou Hanrei No. 1000, p.50*)).

9. In your jurisdiction, is it common practice to include a restriction on the employee leaving the employer to work for a customer?

This is not common practice in Japan. The Japanese Constitution guarantees the freedom to choose an occupation to the extent that it does not interfere with public welfare (*Article 22*); based on this right, caution should be exercised in restricting the employee's freedom to choose their occupation.

10. Specifically, is *Standard document, Restrictive covenant clauses: International: clause 2.1(c)* which restrains the employee from employing or facilitating the employment of their former colleagues usually included as a restriction in your jurisdiction? If so, is it likely to be enforceable?

It is not that usual to include such a restriction in the covenants, although it **is** usual to include the restriction on the solicitation of customers. That said, such a restriction is likely to be enforceable (as long as it is not seen as too broad and too restrictive to be against public policy or morality). It is worth noting that, once such a covenant is breached, it would be very difficult to reinstate the situation and the only remedy would be monetary compensation.

Limitations on restrictions

© 2020 Thomson Reuters. All rights reserved.

11. In *Standard document, Restrictive covenant clauses: International: clause 2.2*, what percentage (%) shareholding is commonly inserted into a clause such as this clause in your jurisdiction?

It is not very usual to include a specific percentage in such a restriction; rather, the market practice tends to be for these covenants to prevent an employee from holding sufficient shares to hold a controlling interest over a company.

Ambit of the restrictions

12. In your jurisdiction, does *Standard document, Restrictive covenant clauses: International: clause 2.3* have the effect of ensuring that the covenants apply when necessary, even if the individual is simply providing information to others in order to allow them to compete, rather than acting in breach of the covenants themselves?

Yes. As long as it is agreed voluntarily by the parties, such a clause would be effective.

Enforceability

13. In your jurisdiction, are restrictive covenants void as an unlawful restraint of trade?

In general, restrictive covenants are considered to be legal and valid under the Japanese law; that said, if they restrict the rights of the employees so broadly and strictly as to be deemed against public policy and morality, they will be deemed to be unlawful and void.

14. In your jurisdiction are restrictive covenants only enforceable if they are narrowly drafted?

© 2020 Thomson Reuters. All rights reserved.

Yes, because there is a possibility that restrictive covenants will be deemed invalid if they restrict the rights of the employees so broadly and strictly as to be deemed against public policy and morality.

15. What terminology may be used in your jurisdiction in relation to the scope of the restrictions?

The following terminology is usually used:

- The employer's activity/business.
- The product/service the employer provides.
- The actual work the ex-employee will engage in.
- The geographic territory covered by the employer's business.

16. To increase the enforceability of restrictive covenants in your jurisdiction, is it beneficial for the covenants to explain why the employer needs to have the protection contained in the restrictions?

Yes. When the validity of the covenants become an issue, it will generally be determined based on the balance between the need for protection of the business and the level of impact on the employee's rights. From the employer's perspective, it is therefore beneficial to include an explanation regarding the necessity of these restrictions.

17. What legitimate business interests may be recognised in your jurisdiction as being capable of protection by restrictive covenants?

In order for the legitimate business interests to be recognised, it is necessary to establish that:

- The company has valuable assets such as business information, technology and know-how.
- The restrictive covenants are necessary to protect those assets.

© 2020 Thomson Reuters. All rights reserved.

18. To increase the enforceability of restrictive covenants in your jurisdiction, must they be limited in terms of the restricted activities?

Yes. The more limited the terms are, the more likely the covenants are to be enforceable. The enforceability of covenants will be determined on multiple other factors, such as:

- The purpose of the restriction.
- The position of the employee during their employment.
- The scope of the restriction.
- Whether or not the company provided any alternative benefits.

19. To increase the enforceability of restrictive covenants in your jurisdiction, should any competitors be specifically listed? Are there any potential disadvantages or consequences of listing the competitors, that is, those not listed may not then be included?

No, there is no requirement to list out the specific competitors.

To do so runs the risk that companies which are not listed may not be included in the restriction.

However, it may be useful to include a list of competitors if they are described as being included on a non-limiting basis, as examples only. These examples would provide more foreseeability regarding the scope of the restriction, and the likelihood of the restriction's validity and enforceability would therefore be increased.

20. To increase the enforceability of restrictive covenants in your jurisdiction, must they be limited in terms of the restricted period of time? If so, what is this period likely to be in practice?

© 2020 Thomson Reuters. All rights reserved.

Yes. The scope of restrictive covenants must be limited to that necessary to protect the legitimate interest of the business (see *Question 16*).

It is therefore impossible to specify a particular period of time which is likely to be valid, and it should be remembered that the duration of a restrictive covenant is just one element in determining its validity. For example, the courts have held in some cases that two years was too long, and so invalid (*see, for example, Fukuoka District Court judgment 5 October 2007 (Roudou Hanrei No. 956, p. 91)*), while in other cases they held that two years was valid to protect the business interest (*see, for example, Tokyo District Court judgment 18 November 2008 (Roudou Hanrei No. 980, p. 56)*).

21. To increase the enforceability of restrictive covenants in your jurisdiction, must they be limited in terms of the restricted geographical area? If so, what is this geographical area likely to be in practice?

Yes. Its scope must be limited to that necessary to protect the legitimate interest of the business. Therefore, it is impossible to specify a level of geographic restriction likely to be valid. In the case of a global company, a broader geographical scope in the restrictive covenant may be deemed necessary to protect the company's legitimate interests than would be required to protect the interests of a domestic company.

It should be also be remembered that the geographic scope is just one element in determining the covenant's validity, and the courts would also consider other factors such as:

- The purpose of the restriction.
- The employee's position during their employment.
- The covenant's impact on the employee's rights, such as whether the company provided any alternative benefits.

22. In your jurisdiction, is it necessary for the restriction to reflect the employee's role and job level?

Yes. The restriction must be limited to what is necessary to protect the legitimate interest of the business, which means in practice that its validity will depend on the employee's role and job level. For example, an employee working as an executive would be likely to have more access to trade secrets than a staff level employee, and it will therefore be more necessary to restrict them from disclosing such trade secrets outside the company.

© 2020 Thomson Reuters. All rights reserved.

23. Will the reasonableness of any restraints be considered more by reference to the status of the employee at the time of entering into the restraint as opposed to on termination of their employment?

It will be considered more by reference to the status of the employee on termination of their employment. To be precise, it relates to the employee's experience (that is, not only the position at the termination, but the positions through their tenure), as the scope of the protected business interests to which the employee has had access will depend on the positions they have held throughout their employment).

Garden Leave

24. Can an employee be placed on garden leave prior to termination in your jurisdiction, that is a period during which the employee remains employed and bound by their employment terms but is released from their duties, usually prior to termination (see *Standard document, Restrictive covenant clauses: International: clause 2.4*)?

Yes. The employer must pay the full amount of salary during any garden leave.

25. If the answer to the question above is "yes", will the inclusion of a clause such as *Standard document, Restrictive covenant clauses: International: clause 2.4* (which reduces the period of the restriction by the garden leave period) increase the likelihood of the restriction being enforceable?

Yes. If the restrictive period is reduced by the garden leave period, it will result in a shortened restrictive period (counting from the termination date), which is more favourable for the employee; this therefore it increases the likelihood of the enforceability of the restriction.

Potential future employer

© 2020 Thomson Reuters. All rights reserved.

26. Is the requirement for the employee to give any person making an offer to them a copy of these restrictions, as set out in *Standard document, Restrictive covenant clauses: International: clause 2.5*, permitted and enforceable in your jurisdiction?

Yes. It is permissible and enforceable to oblige the employee to share the covenants with any potential employer to strengthen the protection by making that potential employer aware of the restriction. The notification to the potential employer would also make it easier for the current employer to bring a tort claim or file for injunctive relief against the potential employer where there is any breach of the covenant by the employee.

27. Is the requirement for the employee to tell their employer the identity of any person and business concern making an offer to the employee, as set out in *Standard document, Restrictive covenant clauses: International: clause 2.5*, permitted and enforceable in your jurisdiction?

If the employee voluntarily agrees to such a covenant, this is permitted and enforceable under Japanese law. However, if the employee does not agree, the employer cannot make them sign such a covenant.

Separate legal advice

28. Is it common practice to include the wording of *Standard document, Restrictive covenant clauses: International: clause 2.6* in restrictions in your jurisdiction (that is, stating that the parties have entered into the restriction having obtained separate legal advice) so as to increase the likelihood for the restriction to be enforceable?

The inclusion of this wording is not common in Japan; that said, such a clause would increase the likelihood of the restriction being enforceable, by emphasising the employee's acknowledgment of their own rights.

Severability

© 2020 Thomson Reuters. All rights reserved.

29. Is a severability clause as set out in *Standard document, Restrictive covenant clauses: International: clause 2.7* likely to be valid and enforceable in your jurisdiction?

Yes, this is likely to be valid and enforceable in Japan.

Transfer of a business

30. Is *Standard document, Restrictive covenant clauses: International: clause 2.8* (requiring the employee to enter into a corresponding agreement with any new employer on the transfer of the employer's business) common practice and likely to be enforceable in your jurisdiction?

Such a provision is not common in Japan; however, if the employee voluntarily agrees to such a covenant, it would be permitted and enforceable under Japanese law.

31. On the transfer of a business in your jurisdiction, will any agreement (containing restrictive covenants) entered into between the original employer and the employee transfer to the new employer automatically?

In Japan, employment does not transfer automatically on a pure transfer of business.

However, when employment is transferred together with the transfer of business, and if there is no consent by the employee, the two employers must agree to a full transfer of all the rights and obligations under the employment contract with the original employer to the new employer, including the restrictive covenants. For avoidance of doubt, the two employers can change the rights and obligations under the employment contract only with the agreement with the employee.

32. If the answer to the above question is "yes", will any post termination restrictions that automatically transfer continue to relate to the original employer/the transferor's business (that is,

© 2020 Thomson Reuters. All rights reserved.

because this was the entity that the subject matter of the restrictions applied to at the time the agreement was entered into)?

Where all the rights and obligations under the employment are transferred (see *Question 31*), the original employer is usually deemed to no longer retain any contractual relationship with the employee, and so the restrictive covenants will not relate to the original employer unless otherwise agreed.

Group companies

33. At the start of *Standard document, Restrictive covenant clauses: International: clause 2.1*, is the inclusion of wording that the employer is taking the benefit of the restrictive covenants "for and on behalf of any Group Company" likely to enable the interests of group companies to be protected in your jurisdiction?

Whether the inclusion of such a clause is likely to enable the interests of group companies to be protected will depend on the situation. If the employee had access to trade secrets relating not only to one of the group companies which they worked for but to all of them, then such business interests would merit protection and the wording would be valid and enforceable. But if such a legitimate interest cannot be identified, the restriction relating to the other companies in the group will be deemed to be too broad and so invalid and unenforceable.

34. If a clause seeking to include the interests of group companies in relation to any restrictions is permitted in your jurisdiction, would the interests of the following entities be protected:

- Subsidiaries?
- Parent company?
- Other companies in the group?

Whether the business interests can be protected or not would depend on the contents of the business interests at issue; therefore, it cannot be determined only by the type of group companies. That said, if the company can show that the business interests were valid, then any of the entities listed in the question can be protected.

© 2020 Thomson Reuters. All rights reserved.

35. Is *Standard document, Restrictive covenant clauses: International: clause 2.9* (requiring the employee to enter into a separate agreement with any group company in respect of the restrictions) common practice and likely to be enforceable in your jurisdiction?

Such a clause is not common in Japan; however, if the employee voluntarily agrees to it, it would be enforceable under Japanese law, assuming that it is deemed to be an appropriate means of protecting the legitimate business interests of that entity.

36. Is there any third-party rights legislation in your jurisdiction that would enable any group company to enforce restrictive covenants that are entered into:

- in the initial contractual terms of employment between the employer and the employee; or
- in a separate agreement containing the restrictions between the employer and employee (for example, a termination or settlement agreement)?

Yes. Article 537 of the Japanese Civil Code provides for third-party (beneficiary) rights, and if such a covenant is executed and determined to be valid, the third party is entitled to claim for such rights in accordance with the covenant, regardless of the form of the covenant.

Consideration

37. In your jurisdiction, at the time of entering into these restrictions, does the employer need to provide consideration to the employee?

No. Under Japanese law, parties can enter into an agreement under which only one party owes an obligation; it is not therefore necessary for an employer to provide consideration.

© 2020 Thomson Reuters. All rights reserved.

38. If consideration is required, what can this consideration be in your jurisdiction?

N/A.

39. If it is permissible in your jurisdiction for the restrictions to apply to any group company, will that entity need to provide separate consideration from that provided by the employer when the employee entered into the restrictions?

No.

40. What are the consequences in your jurisdiction if the employer does not provide any consideration to the employee when they enter into restrictive covenants (for example, will the restrictive covenant be void and unenforceable)?

N/A.

Compensation

41. In your jurisdiction, is the employer required to provide compensation to the employee in relation to the restrictive covenants (for example, payments for the period of restriction)?

No. (However, it is common for restrictive covenants to link receipt of retirement allowance (this is a payment on termination of employment, rather than a pension) to compliance with restrictive covenants (see *Question 51*)).

© 2020 Thomson Reuters. All rights reserved.

42. If the employer is required to pay compensation to the employee, how much is payable?

N/A.

43. If the employer is required to pay compensation to the employee, when is the compensation payable?

N/A.

44. Is the employer able to waive any restrictive covenants at the time of termination in your jurisdiction? If so, how can the employer do this?

Yes. Restrictive covenants are to protect the employer's business interests, and it is therefore permissible for the employer to waive them. The employer can do so orally or in writing, but it would be advisable to prepare any waiver in writing, for evidentiary purposes.

45. Will the employer still have to pay the compensation during the post-termination period of the restriction even if the employee finds alternative employment that does not breach the restrictive covenants with the employer?

N/A.

© 2020 Thomson Reuters. All rights reserved.

46. If the employer is able to waive the restrictive covenants, what amounts may be payable to the employee (for example, is the compensation sill payable to the employee in full or a reduced sum)?

N/A. (However, it is common for restrictive covenants to link receipt of retirement allowance to compliance with restrictive covenants (see *Question 51*)).

Execution and other formalities

47. Do restrictive covenants have to be in writing in your jurisdiction in order for them to be valid and enforceable?

No. It is not necessary for restrictive covenants to be prepared in writing to be valid and enforceable under Japanese law. That said, it is highly advisable to record them in writing, for evidentiary purposes.

48. What are the execution and other formalities that are required for restrictive covenants to be valid and enforceable in your jurisdiction?

There are no particular execution or other formalities.

49. In your jurisdiction do the restrictive covenants need to be registered or require any formal approval?

No.

General

© 2020 Thomson Reuters. All rights reserved.

50. Are any of the restrictive covenant clauses set out in *Standard document, Restrictive covenant clauses: International* not legally valid and enforceable or not standard practice in your jurisdiction?

All the clauses could be legally valid and enforceable if the agreement is made voluntarily between the parties, assuming that a legitimate business interest is served by these covenants.

That said, the inclusion of clauses such as *Standard document, Restrictive covenant clauses: International clauses 2.1(c)*, *2.8* and *2.9* are not standard practice in Japan.

51. Are there any other clauses that would be usual to see in restrictive covenant clauses and/or that are standard practice in your jurisdiction?

It is common practice to link the employee's retirement allowance to their compliance with the restrictive covenants; this means that, if the employee breaches the restrictive covenants, either or both of the following may occur:

- They are not entitled to receive their retirement allowance (either in part or in full).
- They are obliged to repay the retirement allowance (either in part or in full) to their employer, where they have already received their retirement allowance.

In Japan, it is not uncommon for an employer to pay retirement allowance as a deferred payment of salary and/or privilege for the continuous service provided to the company.

The validity and enforceability of such an agreement (that is, the agreement the linking of the retirement allowance to compliance with the covenants (including the amount to be paid back, if any)) will be determined by multiple elements, including:

- The purpose of the retirement allowance (if the allowance is interpreted as a deferred payment of salary, it is more likely to be determined that such reduction is not allowed; but it is interpreted as purely a gift for continuous service, then it is more likely to be determined that such a reduction is allowed).
- The reason for the employee leaving the company (for example, in a case where the employee had no choice but to resign from the company because of the harsh attitude of the company, including a reduction of salary, the courts have determined that such background behaviour means that the employer cannot reduce the retirement allowance (*Nagoya High Court judgment 31 August 31 1990 (Roudou Hanrei No.569, p. 37)*)).

© 2020 Thomson Reuters. All rights reserved.

- The impact on the employee's rights of such an agreement (if the covenant is sufficiently restrictive that it makes the employee feel hesitant about leaving the company, it will be more likely to be determined that the covenant is not valid).
- The business necessity of such a provision.

Remedies for breach

52. What remedies are available for breach of restrictive covenants? How long will each remedy take to obtain in your jurisdiction?

The employer can:

- File for injunctive relief.
- Bring a claim for damages.
- Bring a claim for repayment of some or all of the retirement allowance (see *Question 51*).

When injunctive relief is chosen as a remedy by the employer, it is common for the employer to files a request for a provisional order (not a normal claim for injunctive relief), so as to accelerate the legal process and obtain the order from the court before the breach is actually committed.

The timeline for remedies will vary, depending on the complexity of the background facts and other elements; however, it generally takes:

- Approximately one to three months for a provisional order to be issued, where injunctive relief is sought.
- Approximately one to one and a half years for a judgment to be issued in a claim for damages.

53. Would a successful party be able to recover its costs from the losing party for any successful action for breach of restrictive covenants?

Not necessarily. Under the Japanese legal system, the costs in legal proceedings are usually borne by each respective party, unless they agree otherwise. However, in relation to tort claims seeking damages, it is standard practice for

© 2020 Thomson Reuters. All rights reserved.

the court to issue a judgment ordering the losing party to pay about 10% of the winning party's legal fees, the amount of which is determined when the order is issued.

54. If there are no restrictive covenants with the employee, can the employer rely on any other actions or remedies to protect its business, clients, customers or confidential information in your jurisdiction?

Even if there are no restrictive covenants, any information which falls within the scope of "trade secret" under the UCPA will be protected (see *Question 3*); therefore, the employer would be entitled to take remedial action against the employee as far as the employee's behaviour, such as disclosure or use of trade secrets, falls within the scope of the UCPA.

The UCPA provides, among other things, that there must have been a breach of trade secret protections by the employee, (that is, knowingly or as a result of gross negligence). The remedial actions available to the employer under UCPA include:

- A claim for damages.
- A claim for injunctive relief.

Contributor profile

Yuko Kanamaru, Partner

Mori Hamada & Matsumoto
T +81362668542
F +81362668442
E *yuko.kanamaru@mhm-global.com*
W *http://www.mhmjapan.com/en/*

Areas of Practice: Labour/employment, including the formulation and implementation of employment rules, regulations and systems, personal information matters, overwork issues, workplace harassment and unfair labour practices, and litigation and labour tribunal proceedings.

END OF DOCUMENT

© 2020 Thomson Reuters. All rights reserved.