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## Recent Trends and Future Challenges of Digitization Using E-signatures in Japan

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In Japan, a new Digital Agency has been established in September 2021 and legislation to support the digitization of companies and the relaxation of regulations on affixing seals physically is rapidly being prepared, with the laws related to digitization being enacted on May 12, 2021. Further developments in respect of digitalization in various sectors such as governmental procedure, civil procedure and medical sector will be pursued in accordance with the detailed de-regulation plan approved by the Cabinet Office in June 2021. In addition to measures against the COVID-19 pandemic, digitalization has significant advantages such as reforming working styles through working from home, improving work efficiency and strengthening corporate competitiveness. On the other hand, as the degree of dependence on cyberspace increases, the risk of cyberattacks is becoming apparent, and the risk of digitization is also being recognized. In addition, while business efficiency is increasing due to digitization, it is also necessary to deal with impersonation risk.

In this newsletter, the laws and regulations that support the digitization of enterprises and the future challenges of digitization will be explained.

### 1. Digitization of legal affairs of corporates

#### (1) Contract Digitization

In 2020, the Ministry of Justice and other ministries released 3 explanatory notes (otherwise known as Q&As, such as the Q&A on Article 3 of the Act on Electronic Signatures and Certification Business (the "**E-signature Act**")), which provides a certain solution to the admissibility of electronic contracts which are executed by using e-signatures (in particular with respect to third-party type e-signatures

(*jigyoushagata-denshishomei*)<sup>1</sup>). For example, on December 25, 2020, the Financial Services Agency released the "Summary of Issues relating to Abolishing Requirements of Documents, Seals, and Face-to-Face Procedures" (the "**FSA Issues List**"), pointing out that legality of third-party type e-signatures has been improved so that such legality becomes equivalent to those related to stricter types of e-signatures (such as local/contract party-type e-signatures) in terms of admissibility as evidence (for example, whether or not Article 3 of the E-signature Act, which provide for the presumption of due execution of electronic contracts, is applicable)". On the other hand, there are various concerns regarding loan agreements executed in electronic form with corporations, such as admissibility of evidence of electronic contracts and confirmation whether or not the signatory has been duly authorized. In this regard, for example, the results of a survey of companies conducted by the Association of Corporate Legal Departments in the latter half of 2020 were reported as "The Twelfth Legal Division Fact-finding Survey" and it was reported that only 16% of those who responded to the survey, such as listed companies, had introduced electronic contract services such as e-signatures. Therefore, the dissemination of electronic contracts seems to have both theoretical and practical challenges, including psychological resistance.

#### (A) Approach to Electronic Contracts Based on Q&A on Article 3 of the E-signature Act for Companies

There are a variety of approaches to overcome the problems mentioned above by companies that have adopted electronic contracts, and the following are representative.

- (a) Risk-based approach: It is a method of analyzing the legal risks associated with individual contracts based on factors such as (a) the contract amount, (b) whether or not there is a relationship of trust with the other party, and (c) whether or not confidential information such as personal information is included, and classifying them into "low-risk contract type" and "high-risk contract type". With regard to contracts that fall under the category of "low-risk contract type" it is considered sufficient to execute an electronic contract such as by using e-signatures to which Article 2 of the E-signature Act applies ("**Article 2 E-signatures**"), since even paper contracts are often not subject to strict checks other than affixing an unofficial seal (*mitome-in*). On the other hand, since contracts that fall under the category of "high risk contract type" require affixing of the official seal of a representative director which is registered with the Legal Affairs Bureau even in paper contracts, measures such as the execution of electronic contracts by means of e-signatures to which Article 3 of the E-signature Act applies ("**Article 3 E-signatures**") and the combined use of the balancing or comprehensive evidence approach described in (2) below or the hybrid approach described in (3) below may be required.
- (b) Balancing Approach or Comprehensive Evidence Approach: It is a method of using simple e-signatures such as Article 2 E-signatures, by comprehensively evidencing not only the act of attaching an e-signature at the time of execution of a contract, but also the circumstances before

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<sup>1</sup> Third-party type e-signatures mean e-signatures which are encrypted by using secret keys assigned to an e-signature service provider in accordance with the instructions given by the contract party (i.e., the user of the e-signature service). For further details, please refer to our newsletter published in December 2020.

and after such execution. Examples of "evidence of the validity of the contract" that can be used in this approach include evidence from the negotiation process for concluding a contract (such as exchange of emails) and evidence of contract performance (such as the act of payment).

- (c) Hybrid Approach: It is a method to execute a basic contract on a paper basis to confirm and agree on the authority of both parties (by way of providing the relevant representations and warranties in such basic contract) with regard to executing individual contracts in an electronic contract. Although the difficulty of this hybrid approach is that it does not have the benefit of cost reduction and operational efficiency through digitization, it is useful in the transitional period until the practice on the admissibility of evidence related to electronic contracts is established.

#### (B) Digital Society Formation and Development Act

On May 12, 2021, an act for the establishment of related laws to form a digital society (the "**Digital Society Formation and Development Act**") was enacted by the Diet. In the Digital Society Formation and Development Act, the obligation to affix seals, which was particularly the case with respect to real estate transactions, was abolished, and the obligation to put an agreement in writing was also eased. The Digital Society Formation and Development Act has come into effect on September 1, 2021, except for those provisions that require a certain period of preparation before implementation. Due to the Digital Society Formation and Development Act, most of the requirements of "in writing" or "seal" will be replaced by "e-signature".

The following is a summary of the Digital Society Formation and Development Act.

##### (a) Abolition of the Obligation to Affix a Seal

According to the Digital Society Formation and Development Act, the obligation of affixing seals which remained in real estate transactions and in the professional domain such as with respect to certified public accountants will be abolished. However, a requirement to affix a name and/or signature has been maintained in these areas.

##### (b) Relaxation of Obligation for a Written Contract

According to the Digital Society Formation and Development Act, it will be possible to execute contracts "in electronic form" for those such as land lease and house lease contracts that had previously been required to be "in writing".

##### (c) 2021 Deregulation Plan

On June 18, 2021, the Deregulation Plan ("**2021 Deregulation Plan**") has been approved by the Prime Minister and the Cabinet Office. 2021 Deregulation Plan includes wide range of deregulations related to digitization, such as 100% digitization in respect of governmental procedures, promotion of online

application in respect of real estate and commercial registrations, use of third-party e-signatures (i.e., cloud-based e-signatures) in respect of contracts executed by governmental entities or municipalities, digitization of various civil procedures and insolvency procedures and digitization in medical sectors.

## **(2) Digitization of other documents for companies**

Receipts and invoices are indispensable for companies. In the past, costs of paper, printing and of personnel were incurred in transactions, but as the digitization of each document advances, it has become possible to reduce each cost, including enabling accounting work to be carried out through working from home.

### **(A) Receipt**

Article 486 of the Civil Code provides that a performer may request a receipt from the payee in exchange for performance. According to the Digital Society Formation and Development Act, Article 486, Paragraph 2 of the Civil Code will be newly introduced as part of the digital reform. As a result, the person who made the payment can request the person who received the payment to deliver the receipt in electronic form, leading to the digitization of receipts. On July 9, 2021, the Cabinet Office and the Ministry of Justice published the Q&A on Article 3 of the Receipts in Electronic Form (related to the amended Article 486, Paragraph 2 of the Civil Code) and the interpretation of this new provision of the Civil Code has become clearer with such Q&A.

### **(B) Invoice**

According to the website of the National Tax Agency, the "Method of Retention of Qualified Invoices, etc." will be introduced as a method of receiving purchase tax credit for consumption tax from October 1, 2023.

On July 29, 2020, E-Invoice Promotion Association ("**EIPA**") was established, and on December 14 of the same year, EIPA announced that it would establish standard specifications for electronic invoices in Japan based on the international standard Peppol.

An invoice refers to "eligible invoice" which is necessary for deducting purchase tax, and eligible invoice refers to an invoice issued by a taxable business operator who is registered with the district director of the tax office. An "electronic invoice system" is a system aimed at enabling companies to exchange electronic invoices online with their domestic and overseas business partners. By complying with Peppol's standard specifications for electronic invoices, it is possible to use electronic invoices at low cost, and it is expected that not only large companies but also SMEs will be able to use electronic invoices.

The electronic invoice system was initiated in 2019 with the introduction of a multiple consumption tax rate system, with the aim of providing a proper purchase tax credit for consumption tax. Receipt and

storage of receipts under the electronic invoice system enables the receipt of purchase tax credits even in transactions with tax-exempt business operators. However, it has been pointed out that the use of the invoice system is premised on the introduction of a compatible electronic invoice system, and there is a concern that it may impose a further workload on both buyers and sellers.

In addition, e-seals as digital versions of company square seals are being considered in "study group on systems to ensure the reliability of data issued by organizations" and it is expected that e-seals will be used in electronic invoices.

### **(3) Digitization of internal documents for companies**

Companies need to manage and store various documents, but as the digitization of documents progresses, physical storage places for each document become unnecessary, and retrieval, correction, and delivery of information will become easier. The following is an overview of major topics in digitization of internal documents.

#### **(A) Company Law Documentation**

The minutes of the board of directors meetings are subject to the obligation of directors and corporate auditors present to sign or affix their names and seals to the minutes (Article 369, Paragraph 3 of the Companies Act). When the minutes of a board of directors meeting are prepared in electronic form, each attending officer is required to affix an e-signature instead of signing or affixing his/her name and seal (Article 225, Paragraph 1, Item 6 of the Ordinance for Enforcement of the Companies Act). This requirement is equivalent to that required for Article 2 E-signatures.

On the other hand, even if the minutes of the shareholders meeting are prepared in writing, the officers present at the meeting are not obliged to affix their names and seals to the minutes (Article 318, Paragraph 1 of the Companies Act). Therefore, e-signatures are not required even when minutes of shareholders meetings are prepared by means of electronic records. Provided, however, that in the event that a request for inspection or copying is made such as by a shareholder, it is necessary to allow such matters to be displayed in print or as an image (Article 226, Paragraph 1, Item 17 of the Ordinance for Enforcement of the Companies Act). However, in general, there are many cases where a representative's seal is affixed for the purpose of securing the authenticity of the minutes when minutes are prepared in paper format. Therefore, when minutes are prepared electronically, it is desirable to prepare minutes of the shareholders meetings with e-signatures in a method equivalent to that is used for preparation of board minutes as discussed above.

#### **(B) Other Internal Documents**

Internal documents such as internal approval documents (*ringisho*) are different from documents under the Companies Act, and Article 2 E-signatures are not required in respect of internal approval

documents (*ringisho*), provided, however, that it is possible to require affixing Article 2 E-signatures on certain important internal approval documents as a matter of cautious practice.

(C) Electronic Books Preservation Act (so-called *denshichobo-hozonho*)

When digitizing company documents, it is necessary to be aware of the Act on Special Provisions concerning Preservation Methods for Books and Documents Related to National Tax Prepared by Means of Computers (so-called *denshichobo-hozonho*) (the "**Electronic Books Preservation Act**".) as a tax measure. In particular, it has been pointed out in the past that the use of "scanner storage system" which digitizes paper-based documents is not user-friendly. However, in the tax reform of 2021 (which is scheduled to take effect in January 2022), amendments will be made, such as (a) abolishing the requirement of the prior approval of tax offices, (b) omitting the requirement of physical signing of the documents received by the taxpayer, and (c) permitting the use of cloud services that have a history of corrections and deletions.

(D) Virtual shareholders meeting

In February 2020, the Ministry of Economy, Trade and Industry developed and published the "Guide to the implementation of hybrid virtual shareholders meetings" which clarifies legal and practical issues and the specific treatment for companies holding hybrid virtual shareholders meetings.

The methods of identity verification (including measures against spoofing) are discussed in the "Guide to the implementation of hybrid virtual shareholder meetings (separate volume) Casebook (Draft)" as follows:

- Basically, login using ID and password or equivalent.
- Depending on the circumstances, for example, use (1) multiple pieces of information specific to shareholders (such as shareholder number and postal code), and (2) identify the individual by displaying the individual's face and reference number on the screen.
- For shareholders with more than a certain number of voting rights, more careful identification may be possible.

It is considered possible to adopt methods such as two-step authentication or the use of a blockchain if it is considered that spoofing measures should be carefully taken.

## 2. Digitization of governmental and judicial procedures

### (1) Digitization of registration and other governmental procedures

(A) Governmental Procedures (abolition of affixing seal)

According to the "Administrative Procedure Reform Strategies as of March 31, 2021" published by the Council for the Promotion of Regulatory Reform on April 6, 2021, among the 15,611 procedures that require the affixing of a seal, 15,493 procedures were abolished, and only 118 procedures that require

the affixing of a seal were left. Therefore, it can be said that most of the requirements of “in writing” or “seal” in administrative procedures have been abolished and usability has been improved.

#### (B) General Governmental Procedures (digital)

The e-Government (e-Gov) system has been updated to expand the range of applications that can be made by simple methods such as creating an account in e-Government (e-Gov), except for exceptional application procedures that require an electronic certificate. However, from the viewpoint of ensuring convenience and safety, the current treatment is as follows:

- (a) For example, an e-signature using a designated electronic certificate must be used for various notifications and tax returns based on the Financial Instruments and Exchange Act.
- (b) “Designated electronic certificates” are limited to those in respect of which identity confirmation is strictly conducted, in the same manner as the following real estate registration application procedures.

#### (C) Digitization of Company Registration

Company registrations can be filed online. In principle, it is necessary to use an official e-signature of a company issued by the relevant legal affairs bureau (*shogyotoki-denshishomei*) when applying for registration. On the other hand, since 2020, the scope of the use of third-party type e-signatures has been expanded, and certain types of third-party type e-signatures approved individually by the Ministry of Justice have been allowed to be used for documents that were previously allowed to be executed by using an unofficial seal (*mitome-in*). However, use of third-party type e-signatures is still restricted in respect of documents that must be executed by an official registered seal (*jitsuin*), such as an acceptance letter of appointment of a new representative director in the case of a change of representative director. It is expected that use of third-party type e-signatures will be expanded further while ensuring both convenience and safety.

#### (D) Digitization of Real Estate Registration

An online application for real estate registration can be made if certain requirements are satisfied. However, types of e-signatures and electronic certificates are limited to an official e-signature of a company issued by the relevant legal affairs bureau (*shogyotoki-denshishomei*), an official e-signature of a person issued by the relevant governmental office (so-called my number card), and e-signatures provided by certain approved e-signature service providers (including SECOM Passport for G-ID and Judicial Scrivener Electronic Certificate (an electronic certificate issued by a Certified Certification Business Operator to a judicial scrivener belonging to the Judicial Scrivener Association)). In addition, at the 9th Digital Government Working Group of the Regulatory Reform Council held on March 30, 2021, it was confirmed that usability of online application for real estate registration must be improved.

(E) Digitization related to foreign exchange laws

While various reports based on the Foreign Exchange and Foreign Trade Act can be filed online, only electronic certificates issued by the Bank of Japan's system can be used.

The online application system for the Foreign Exchange and Foreign Trade Act is scheduled to be renewed in January 2022.

**(2) Digitization of judicial proceedings**

Judicial proceedings are being considered for digitization from the perspective of “Aim to achieve (1) e-Filing, (2) e-Court, and (3) e-Case Management in civil proceedings (the “3 e”)”.

On February 19, 2021, the Code of Civil Procedure (IT-related) 9th Meeting (Held on 19 February 2021) put together the "Interim Draft for Amendment to the Code of Civil Procedure (IT-related), etc." (the "Interim Amendment Plan"). The outline of the Interim Amendment Plan is as follows.

(A) Online Submission of Complaints and Answers

With regard to a petition to be filed with the court, which is to be filed by way of submitting a paper document, an electronic filing may be allowed. There are currently three proposals made by the Interim Amendment Plan as follows:

- Proposal A: A proposal to make it mandatory to digitize the entire system regardless of whether a person sues by himself/herself or a legal representative is appointed.
- Proposal B: A proposal to make digitization mandatory only when a legal representative is appointed
- Proposal C: A proposal to make physical documents or digital to be optional without making digitization mandatory

(B) Introduction and expansion of web conferences

Digitization of oral proceedings by using web conferences has already started since the fiscal year of 2019.

(C) Countermeasures against Impersonation Risks

According to "II. Filing a lawsuit and submitting a court briefing, Section 2 Personal Authentication Measures in respect of online filing/submission” described on page 19 and subsequent pages of the Supplemental Explanation of the Interim Amendment Plan, an e-signature which can be used in the digitized civil proceedings may be limited to e-signatures provided by approved e-signature service providers and other restricted e-signatures only although it is subject to further discussions.



### 3. Remaining Issues

#### (1) Enhancing Cybersecurity

In recent years, damages caused by cyber attacks have become more serious, such as the theft of confidential information by computer viruses such as ransomware and the demand for money. These cyber attack risks are serious due to the increasing dependence of companies on cyber space reflecting the increase of the number of employees working from home following measures taken during the COVID-19 pandemic. In advancing digitization, companies need to thoroughly examine their cyber security measures, from defense measures as a system to education of executives and employees. In addition, since important data such as contracts are entrusted to the e-signature business operators, it is necessary to examine cyber security measures of the e-signature business operators themselves. In addition, it is desirable to discuss comprehensive policies for digitization, including cyber security measures, with the counterparty to the contract, if the electronic contract is to be executed continuously.

#### (2) Improving Digital Reliability

Based on discussions set out above, there are many types of e-signatures available in Japan and the types of e-signatures which can be used in respect of certain documents or procedures vary depending on types of documents and procedures. At the same time, there are many e-signature service providers (which are or are not approved under the E-signature Act) and it is sometimes argued that an approval system under the E-signature Act must be reformed. More widely, it is pointed out that a comprehensive rule related to various “trust services” must be established which deal with the whole range of electronic authentication services (including e-signatures provided by e-signature service providers, an official e-signature of a company issued by the relevant legal affairs bureau (*shogyotoki-denshishomei*), e-seal and others). On August 16, 2021, “Cloud-based E-signature Service Association” was established by providers of cloud-based e-signature services in order to expand the use of cloud-based e-signature services.

#### (3) Improving usability

From the viewpoint of companies promoting digitization, it is desirable that all documents and procedures are digitized through one type of e-signature provided by one e-signature service provider rather than using various types of e-signatures depending on types of documents and procedures. On the other hand, there are various types of e-signatures available in Japan (including Article 2 E-signatures and Article 3 E-signatures as defined above). In terms of paper documents executed by seals, companies have been using either an official registered seal or an unofficial seal depending on types of documents. Similarly, companies may choose either an Article 2 E-signature or an Article 3 E-signature depending on type of documents. Although use of third-party type e-signatures have been expanded, it is sometimes criticized that third-party type e-signatures may be misused without conducting proper personal identification steps. To respond to such criticism, it

may be an idea to use a third-party type e-signature with enhanced personal identification steps (such as two-factor authentication or personal identification check by reviewing a my-number card).

#### (4) Digitization of cross-border transactions

Japanese companies tend to start examining use of e-signatures in respect of domestic transactions (e.g., contracts executed with a Japanese counterparty). However, it would be also beneficial to digitize cross-border transactions.

On the other hand, there are additional issues to be examined in respect of cross-border transactions, such as an issue related to choice of an appropriate governing law and dispute resolution, legality of e-signatures under the governing law of the contract. It may be efficient and realistic to start using e-signatures in respect of transactions with counterparties in certain countries/jurisdictions in which (a) legality of e-signatures is supported and (b) there are actually many transactions with such countries/jurisdictions.

## 4. Summary

In addition to measures against the COVID-19 pandemic, digitization has a variety of advantages, including changes in working styles, improved work efficiency, and enhanced corporate competitiveness. On the other hand, they are not used in the case of digitalization which is not easy to use, and they cannot be trusted unless a system which can cope with cyber attacks and disasters is established. In order to realize full digitization of internal and external documents, administrative procedures, and judicial procedures, it is desirable to build a digitized society in which convenience and safety are balanced.

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