

Developments in the Japanese renewable energy sector: solar continues to cool as wind picks up

METI has published a set of new tariffs for renewable energy power projects approved this year. As expected, the downward trend in tariffs for solar projects has continued, while tariffs for other renewable energy projects remain the same as for last year. Further, a new tariff for wind power has been set to encourage the development of offshore wind power. This client briefing highlights opportunities for global renewable market players in the growing Japanese renewables market.

Since the introduction of the feed-in tariff (the "FiT") in Japan under the Act on Special Measures Concerning New Energy Use by Operators of Electric Utilities (the "Renewable Energy Act") on 1 July 2012, the Japanese renewables market has seen rapid growth, with the solar sector being particularly successful in attracting investors – in large part down to the shorter implementation period for such projects.

Under the Japanese FiT scheme, the sales price of electricity in relation to each renewable source is revised by the Ministry of Economy, Trade and Industry ("METI") every fiscal year and on 25 March 2014, METI announced the new tariffs for projects approved during the 2014 fiscal year ("FY2014"¹). While for the most part METI has kept tariffs stable for FY2014, the notable changes include:

- (1) a decrease in the sales price for solar power plants from JPY 36 per kilowatt hour to JPY 32 per kilowatt hour; and
- (2) the establishment of a new sales prices for offshore wind farms at a levels - JPY 36 per kilowatt – which is significantly higher than that for onshore wind farms - JPY 22 per kilowatt – to encourage the development of offshore wind farms.

It seems that METI's decision to continue a preferential rate programme for the four non-solar renewable energy sources is the product of its policy to diversify the energy sources of renewable energy power plants in Japan.

Please see Annex 1 for a detailed list of sales prices under the Japanese FiT scheme from the 2012 fiscal year ("FY2012"²) to FY2014.

Reduced tariff for solar projects

METI has steadily reduced solar tariffs, from JPY 40 for FY2012 to JPY 36 for FY2013 down to the new FY2014 tariff of JPY 32 per kilowatt hour. It seems that METI's decision to lower the solar tariff is largely driven by two factors:

- (1) firstly, the reduction in the capital costs – in particular the cost of panels – for solar PV projects, which METI is naturally seeking to capture in the tariffs; and
- (2) secondly – and perhaps more importantly – the desire to reduce the significant appetite in the investor market for solar projects since the introduction of the FiT scheme in July 2012, which has seen large numbers of projects being approved by METI of which many have failed to materialise to date.

¹ FY 2014 refers to 1 April 2014 to 31 March 2015

² FY 2012 refers to 1 July 2012 to 31 March 2013 here, as the Renewable Energy Act only came into effect on 1 July 2012

There is clearly a perception within METI that some of the projects being approved are somewhat speculative, with little actual development work having been done to underpin them. In reducing the tariff for solar projects, METI is perhaps seeking to weed out the more speculative projects, while still providing a good rate of return to serious investors who follow through on their plans.

Although METI is seeking to rein in the solar market somewhat and prevent it from overheating, the overall policy of the Japanese government to increase renewable energy has not changed and the new solar tariff remains competitive in the global renewable energy market. For instance, Japanese Government has already set targets of 13.5% (approximately 141.4 billion kWh) of electricity to be generated from renewable sources in 2020 and 20% (approximately 214 billion kWh) of electricity to be generated from renewable sources in 2030 while the proportion of electricity generated from renewable sources is 10.0% (approximately 104 billion kWh). In the updated Basic Energy Plan published in April 2014, the Japanese Government stated that "we will aim at exceeding the existing renewable energy targets".

Potential revocation of METI approvals

On 28 March 2014, METI also announced a series of regulatory – non-tariff related – changes aimed at ensuring that approved solar projects do indeed come to fruition.

For solar projects approved in FY2014, METI has introduced a 180-day time limit from the date of approval, whereby once a project has been approved, the project operator has to submit written evidence (such as a commercial register extract, agreement, or purchase order) within 180 days of the approval date to prove that (i) the relevant project site has been procured and (ii) the specification details of the solar power plant equipment have been determined, failing which the approval will be revoked.

Similar changes have also been introduced for projects approved in previous fiscal years. On 14 February 2014, METI announced that it would revoke approvals granted in FY2012 for non-operational solar power plant projects if they could not prove that (i) the relevant project sites had been procured or (ii) the specification details of the solar power plant equipment had been determined. METI's intention is to revoke those approvals granted to developers who have postponed construction but continue to occupy desirable project sites with a "locked-in" sales price set in FY2012, who METI believes may be intentionally delaying construction to take advantage of potential reductions in construction costs in the future (particularly PV manufacturing costs).

METI started conducting hearings in March 2014 with all solar power plant developers whose projects had failed to satisfy (i) and (ii) above (estimated to be 672 projects and around 3.03 million kW) in order to confirm whether the procurement of sites could be proven through acquisition agreements or loan agreements and whether it could be proven that equipment had been specified and orders had been placed. If METI finds that either (i) or (ii) has not yet been satisfied, it will rescind the approval granted to such solar power projects.

Separately, other project operators whose solar power projects have failed to satisfy either (i) or (ii) have been given until August to satisfy both conditions. Where METI cannot confirm the satisfaction of both requirements by the end of August 2014, it will hold similar hearings with these project developers.

Given that the steady decrease in tariffs for solar power since FY2012, there has been significant interest from investors in secondary purchases of solar projects that have secured preferable prices from FY2012. Investors looking at any such projects in the secondary market will need to be aware of the threat posed by the changes outlined above and ensure that the relevant project is able to satisfy the criteria in a timely manner by conducting thorough due diligence.

Promotion of Wind Farms

Since the introduction of the FiT scheme in Japan, wind farm developments have not seen the growth that was expected. One of the reasons is that an environmental impact assessment (EIA) is required for the construction of large scale wind farms. Since EIAs involve significant outlay and usually take 3-4 years to complete, they have become a major obstacle to the development of wind farms. In Japan, if the total capacity of a wind farm is 10MW or more, an EIA is compulsory. If the total capacity of a wind farm is 7.5MW or more, the project developers have to complete a screening procedure, and if the

Japanese Government requires, a normal EIA may also be necessary. Furthermore, even for smaller scale wind farms, an EIA may be required by local ordinances. To lighten this burden, the Japanese Government is planning to shorten the examination period of the EIA to enable it to be completed within 1.5 – 2 years. Another obstacle is the shortage of grid capacity in areas suitable for the construction of wind farms (namely, Hokkaido and the Tohoku region). The Japanese Government has expressed its intention to address this concern by facilitating an increase in grid capacity through subsidies or a separate promotional policy.

Since there are a limited number of project sites suitable for onshore wind farms in Japan, the Japanese Government is also hoping to support the expansion of offshore wind farms. As mentioned above, to encourage the development of offshore wind farms, sales prices of electricity from offshore wind farms have now been set at levels (JPY 36 per kilowatt) far higher than that for onshore wind farms (JPY 22 per kilowatt).

Due to limited expertise in developing offshore wind farms in Japan, there are great opportunities for global renewable market players that have an appropriate track record and the necessary know-how, although the deepwater offshore Japan poses different technical challenges to those faced in the mature offshore markets.

Final remarks

The evidence seems to indicate that there has been a change in tide and sentiment in the Japanese Government concerning its support for particular renewable energy sources. Solar power has been slightly de-emphasised in favour of wind power over the medium to long term. In any case, however, Japan is likely to continue to focus on renewable energy, given the uncertainties surrounding the reactivation of nuclear power as a stable domestic energy source, and as such, the Japanese renewable energy market should continue to offer opportunities for global investors.

Where Japanese legal concepts have been expressed in English, the concepts concerned may not be identical to the concepts described by the equivalent English terminology as they may be interpreted under the laws of other jurisdictions.

Annex 1: List of Sales Prices under Japanese FIT (FY2012-FY2014)³⁴

Type of Power Generation		Price Rate (per kWh) in the 2014 fiscal year (April 2014 – March 2015) (w/o Tax)	Price Rate (per kWh) in the 2013 fiscal year (April 2013 – March 2014) (w/o Tax)	Price Rate (per kWh) in the 2012 fiscal year (July 2012 – March 2013) (w/o Tax)	Sales Period
Solar Power	10kW or more	JPY 32.00 (USD 0.31)	JPY 36.00 (USD 0.35)	JPY 40.00 (USD 0.39)	20 years
	Less than 10kW	JPY 37.00 (USD 0.36) (including Tax)	JPY 38.00 (USD 0.37) (including Tax)	JPY 42.00 (USD 0.41) (including Tax)	10 years
	Less than 10kW (in case of dual generation)	JPY 31.00 (USD 0.30) (including Tax)	JPY 31.00 (USD 0.30) (including Tax)	JPY 34.00 (USD 0.33) (including Tax)	10 years
Wind Power	20kW or more	JPY 22.00 (USD 0.21)			20 years
	Less than 20kW	JPY 55.00 (USD 0.53)			20 years
	Offshore Wind Power ⁵ (New)	JPY 36.00 (USD 0.35)	N/A		20 years
Geothermal Power	15,000kW or more	JPY 26.00 (USD 0.25)			15 years
	Less than 15,000kW	JPY 40.00 (USD 0.39)			15 years

³ USD values are calculated at an exchange rate of USD 1.00 = JPY 103 in this Annex. Correct as at 31 March 2014.

⁴ Sales prices are determined on a no tax inclusion basis for future increases in the tax rate, except for solar power (less than 10kw).

⁵ Offshore wind power plants whose construction and operation requires vessels or other platforms.

Type of Power Generation		Price Rate (per kWh) in the 2014 fiscal year (April 2014 – March 2015) (w/o Tax)	Price Rate (per kWh) in the 2013 fiscal year (April 2013 – March 2014) (w/o Tax)	Price Rate (per kWh) in the 2012 fiscal year (July 2012 – March 2013) (w/o Tax)	Sales Period
Mid-Small Size Water Power	1000kW or more – less than 30,000kW	JPY 24.00 (USD 0.23) JPY 14.00 (USD 0.14) ⁶	JPY 24.00 (USD 0.23)		20 years
	200kW or more – less than 1000kW	JPY 29.00 (USD 0.28) JPY 21.00 (USD 0.20) ⁷	JPY 29.00 (USD 0.28)		20 years
	Less than 200kW	JPY 34.00 (USD 0.35) JPY 25.00 (USD 0.24) ⁸	JPY 34.00 (USD 0.33)		20 years
Biomass	Recycled woody biomass	JPY 13.00 (USD 0.13)			20 years
	General recycled biomass (other than recycled woody biomass)	JPY 17.00 (USD 0.17)			20 years
	General woody biomass (including palm kernel shells)	JPY 24.00 (USD 0.23)			20 years
	Woody biomass (unused wood)	JPY 32.00 (USD 0.31)			20 years
	Methane fermented gas biomass (sewage sludge, etc.)	JPY 39.00 (USD 0.38)			20 years

⁶ Renewal of electronic equipment and hydraulic steel pipes of the existing supply canal

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