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Developments in Japan's renewable energy sector: how to benefit from the new feed-in tariff

Japan's new feed-in-tariff (the "Japanese FiT") became effective on 1 July 2012. We have reviewed the applicable legislation (the Act on Special Measures concerning Procurement of Renewable Energy by Utility Companies (the "Renewable Act"), the relevant cabinet ordinances and answers to public comments by the Ministry of Economy, Trade and Industry ("METI") published on 18 June 2012) and in this briefing note we explain some practical steps required for a developer to take advantage of the Japanese FiT.

The procedures required have become clearer, save for some terms of agreements for grid-connection and electricity supply, which will be determined by the evolution of market practice.

The three phases

We consider the practical aspects of renewable power plant development in three phases:

Phase 1 - Planning: Obtaining Plant Approval and applying for Grid Connection Approval
■ Planning – Selecting the site location and the most appropriate generating equipment – Preliminary consultation with a utility company ("**Utility**") in respect of its grid-connection capability – Determining the facility specification
■ Approvals to be obtained or applied for: – Obtaining approval from METI for the construction of the power plant ("**Plant Approval**") – Submitting an application to a Utility for approval of a grid-connection ("**Grid Connection Approval**") – Obtaining any other applicable licenses, approvals or notifications as required by the applicable legislation
Phase 2 - Execution: Obtaining grid connection approval, entering into GSA and ECA, and construction
■ Grid Connection Approval to be granted by a Utility
■ Agreements: an Electricity Sale Agreement ("**ESA**") and a grid-connection agreement ("**GCA**") to be negotiated and executed with a Utility
■ Purchasing or leasing the project site (which may take place before or after execution of ESA/GCA)
■ Commencement and completion of construction
■ Testing
Phase 3: Operation
■ Commencement of business: following test operations, power supply to a Utility can begin

Phase 1 - Planning: Obtaining Plant Approval and applying for Grid Connection Approval

Main approvals for Japanese FiT

There are two main approvals needed in order to be able to take advantage of the Japanese FiT under the Renewable Act:

1. Plant Approval to be obtained from METI; and
2. Grid Connection Approval to be obtained from a Utility.

The main criteria which METI will consider for grant of Plant Approval are:

(a) There should be a reasonable degree of probability that the operator's electricity generation business at the site will become operative (it is difficult at this stage to predict the level of probability required here since there is no clear guideline published yet on how METI will determine such "reasonable degree of probability").

(b) The site location, the manufacturer and the equipment specifications (such as a model number) of the power plant have already been determined.

(c) The power plant is designed to be capable of monitoring the amount of electricity it provides to a Utility.

(d) The operator can clearly access maintenance services in Japan on a full-time basis, and maintenance work can start within three months from occurrence of a technical problem at the power plant (which will be accessed by item (2) of the ancillary documents below).

(e) Electricity generation is provided in a way that a breakdown of the setup costs and operation costs of the power plant will be recorded within the power plant (for instance, by a data centre built in the power plant) (such data will be provided to METI for the purpose of determination of sales price in the future).

Practical Aspects of Plant Approval

As is apparent from items (a) and (b) of the above criteria, the construction of the power plant does not need to have started before the operator can apply for a Plant Approval, however, it is necessary to determine the details of the site location and equipment specifications of the power plant before an application can be made.

In terms of the site location, the operator is able to either purchase or lease the relevant land.

Furthermore, a special purpose company ("**SPC**") can apply for a Plant Approval.

Documents Required for Plant Approval

In addition to the application form, there are certain ancillary documents to be submitted to METI which include:

1. Documents concerning electricity generating capacity (such as a certificate issued by a manufacturer which shows the name of the manufacturer and the serial number of the power plant);
2. Documents concerning checking of, maintenance and repair service for the power plant (such as a maintenance agreement); and
3. Power plant structure diagrams (*kozo-zu*) and connection diagrams (*haisen-zu*).

Typical Processing Period for Plant Approval

According to METI, a Plant Approval typically takes one month from the submission of an application if the power plant produces electricity from solar, wind, water or geothermal power, and three months if from biomass energy sources.

Necessity for due diligence of other applicable licenses, etc

In each individual case, it will also be necessary to conduct due diligence to determine any other requirements for licenses, approvals or notices under the applicable law to which the project may be subject. This may include:

- the Act for Assessment of Environmental Impacts
- the Agricultural Land Act
- the Building Standards Act
- the Factory Location Act
- any local government regulations applicable to the specific project site

Phase 2- Execution: Obtaining Grid Connection Approval, entering into GSA and ECA, and construction

Electricity Sales Agreement and determination of the Sales Price

The sales price of electricity under the Japanese FiT is determined by METI in respect of each fiscal year in Japan (i.e., 1 April to 31 March). For instance, the sale price for the fiscal year 2012 (i.e., the period starting from 1 July 2012 (on which the Japanese FiT became effective) and ending 31 March 2013) ("**2012 Sales Price**") has been determined by METI as shown in the Annex to this briefing. The 2012 Sales Price has been determined to be higher than the standard sales price in the future (i.e., aiming to achieve pre-tax IRR (Internal Rate of Return) of 6 to 8% in case of a solar power plant) in order to boost investment into renewable energy projects. The sales price for the fiscal year 2013 (i.e., 1 April 2013 to 31 March 2014) and thereafter will be determined by METI taking into account the profitability of operators of renewable energy power plants and broader economic circumstances. In terms of the sales price in the future, the Renewable Act specifically mentions that the sales price for the first three years from the commencement of the Japanese FiT (i.e., the fiscal years 2012 to 2014) shall be determined taking special considerations of profits of plant operators. Therefore, it is expected that the sales price for the fiscal years 2012 to 2014 will be higher than the sale price for the fiscal year 2015 and thereafter.

In order to enjoy the benefit of 2012 Sales Price, the operator must have (a) obtained a Plant Approval and (b) applied for a Grid Connection Approval (such application has been received by a Utility) prior to 31 March 2013 (i.e., such Grid Connection Approval does not need to be obtained prior to 31 March 2013). Accordingly, if both of the conditions (a) and (b) are satisfied prior to 31 March 2013, the operator will be, in principle, able to enjoy 2012 Sakes Price during the sales period specified in the Annex. On the other hand, if any of the conditions (a) or (b) is not satisfied in respect of a power plant prior to 31 March 2013 and the conditions (a) and (b) are satisfied prior to 31 March 2014, the sales price for the fiscal year 2013 (which will be determined by METI by 31 March 2013) will apply to such power plant.

The Renewable Act entitles METI to amend the fixed sales price which has been published if, for instance, there is any significant change to commodity price or other economic circumstances. However, it is expected that an amendment to the fixed sales price which has been published will be implemented only in extreme circumstances in order to maintain the stability of the Japanese FiT. Please note that the fixed sales price is not directly linked to consumer price index or other indices, and therefore, it can only be amended by METI's determination in accordance with the Renewable Act.

The ESA (*tokutei-keiyaku*) and the GCA

Although the ESA and the GCA are defined and regulated separately under the Renewable Act, both agreements may, in practice, be entered into as one agreement as long as the parties to both agreements are the same (i.e., a Utility is in charge of both grid-connection and electricity purchase). In order to meet the requirements of the Renewable Act, the ESA and GCA must provide that (a) a Japanese court shall have exclusive jurisdiction, (b) the governing law shall be Japanese law and (c) the original language of the contract shall be Japanese language (although an English translation can be prepared).

The parties can freely negotiate and decide the terms and conditions of the ESA and the GCA, except for the sales period and the sales price. However, the Renewable Act allows a Utility to refuse execution of the ESA and/or the GCA in limited circumstances (as set out below), which should be taken into account when drafting the ESA and the GCA.

Refusal by a Utility to execute the ESA and/or the GCA

The Renewable Act entitles a Utility to refuse to execute the ESA and/or the GCA in limited circumstances including if the ESA or GCA which is proposed by the developer contains the following terms:

1. The ESA or the GCA obliges a Utility to pay compensation for damages incurred by a supplier of electricity (i.e., an operator of the power plant, a "**Supplier**") even if such damages are not attributable to a Utility.
2. The ESA or the GCA obliges a Utility to indemnify a Supplier in respect of damages which exceed the actual damages incurred by a Supplier.
3. A Supplier does not allow a Utility to conduct the monitoring it requires in order to maintain proper performance of the power plant.
4. The amount of electricity to be provided by a Supplier is reasonably expected to exceed the capacity of a Utility (provided that a Utility shall provide a Supplier with documentary evidence which shows such capacity problem prior to or upon refusal).

Time Limit for Refusal

A Utility must answer as to whether or not it will grant a Grid Connection Approval within three months from receipt of the application by a Supplier. Technically speaking, an application for a Grid Connection Approval and execution of the GCA are separate procedures. However, it depends on the regional Utilities whether such two procedures can be pursued simultaneously.

Curtailment Risk – potential suspension of electricity supply by a Utility without compensation

The Renewable Act entitles a Utility to suspend electricity supply by a Supplier without any compensation in case of limited circumstances, for instance:

1. Despite the fact that a Utility has taken certain actions to reduce electricity supplied to it, it is still expected that electricity supply from a Supplier will exceed the Utility's needs, provided that (i) the Utility is entitled to suspend electricity supply from a Supplier that is an operator of the power plant with a capacity of 500kW or more and (ii) the Utility is entitled to suspend electricity supply for up to 30 days per year.
2. One of the compelling reasons as set out in the Renewable Act applies (for example, force majeure, accidents, and necessity of quality checks).

If none of the above reasons exists and a Utility wishes to suspend electricity supply by a Supplier, the Utility shall compensate for any "actual damages" incurred by a Supplier. "Actual damages" are calculated by the expected amount of electricity supply (that would have been supplied if there had been no suspension) multiplied by the fixed sales price under the Japanese FiT.

Phase 3: Sales/Operation Period

The sales period commences when the power supplier starts supplying electricity to a Utility under the ESA following the completion of testing. Please note that, in practice, the sole customer for a plant operator would be the regional Utility given the absence of a market or of other offtakers although it may change in the future.

During the sales period, an **annual report** on construction costs and operating costs needs to be submitted to METI. If the power plant is a biomass power plant, an operator also needs to keep the relevant **accounting books** for 5 years.

An operator is required to obtain a prior approval from METI for any proposed changes if there is any change to a substantial part of a power plant which has obtained a Plant Approval while an operator is required to file an amendment notification with METI if there is any change to a minor part of a power plant.

An operator is also required to file an **abolishment notification** with METI if such operator ceases to generate electricity from the power plant which has obtained a Plant Approval.

Final Remarks

Following the implementation of relevant regulations and METI's answers to public comments published, the required procedures in respect of each of three Phases as set out above have become clearer. There is still some uncertainty as to the content that needs to be incorporated into ESAs and GCAs to which a Utility is a party. However, the process of drafting and negotiation of the ESA and GCA and its terms will become clearer once market practice develops although such market practice have not been developed yet. The one key issue to monitor is the sales price which will be determined by METI in respect of the fiscal year 2013 or thereafter. Accordingly, attention must be paid to this sales price in order to determine the profitability of potential renewable power projects in respect of which approvals will be obtained in the fiscal year 2013 or thereafter.

Where Japanese legal concepts have been expressed in the English language, 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: List of 2012 Sales Price[1]

Type of Power Generation		Price Rate (per kWh) (w/o Tax)	Price Rate (per kWh) (w Tax)	Sales Period
Solar Power	Less than 10kW	JPY 42.00 (USD 0.53)	JPY 42.00 (USD 0.53)	10 years
	Less than 10kW (in case of dual generation)	JPY 34.00 (USD 0.43)	JPY 34.00 (USD 0.43)	10 years
	10kW or more	JPY 40.00 (USD 0.50)	JPY 42.00 (USD 0.53)	20 years
Wind Power	Less than 20kW	JPY 55.00 (USD 0.69)	JPY 57.75 (USD 0.72)	20 years
	20kW or more	JPY 22.00 (USD 0.28)	JPY 23.10 (USD 0.28)	20 years
Geothermal Power	Less than 15,000kW	JPY 40.00 (USD 0.50)	JPY 42.00 USD (0.53)	15 years
	15,000kW or more	JPY 26.00 (USD 0.33)	JPY 27.30 (USD 0.34)	15 years
Mid-Small Size Water Power	Less than 200kW	JPY 34.00 (USD 0.43)	JPY 35.70 (USD 0.45)	20 years
	200kW or more – less than 1000kW	JPY 29.00 (USD 0.36)	JPY 30.45 (USD 0.38)	20 years
	1000kW or more – less than 30,000kW	JPY 24.00 (USD 0.30)	JPY 25.20 (USD 0.32)	20 years
Biomass	Recycled woody biomass	JPY 13.00 (USD 0.16)	JPY 13.65 (USD 0.17)	20 years
	General recycled biomass (other than recycled woody biomass)	JPY 17.00 (USD 0.21)	JPY 17.85 (USD 0.22)	20 years
	General woody biomass (including palm kernel shell)	JPY 24.00 (USD 0.30)	JPY 25.20 (USD 0.32)	20 years
	Woody biomass (unused wood)	JPY 32.00 (USD 0.40)	JPY 33.60 (USD 0.42)	20 years
	Methane fermented gas biomass (sewage sludge, etc.)	JPY 39.00 (USD 0.49)	JPY 40.95 (USD 0.51)	20 years

[1] USD is calculated at the exchange rate of USD 1.00 = JPY 80.00 in this Annex.

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