

OFFSHORE WIND: NEXT STOP JAPAN

Offshore wind has arrived in Asia Pacific. Taiwan leads the region, with several commercial scale projects underway, including the trailblazing 128MW Formosa 1 Project (*IJGlobal Asia Pacific Offshore Wind Deal of the Year 2018 and PFI Asia Pacific Renewables Deal of the Year 2018*). Attention is now increasingly focused on what is widely considered to be one of the region's most promising jurisdictions for the development of major offshore wind (OSW) projects – Japan.

CURRENT STATE OF PLAY

As in Taiwan, which started with near-shore OSW projects, Japan has begun to develop OSW facilities in and around existing port areas.

The importance of near-shore projects in laying the foundations for the OSW industry should not be understated. This includes the negotiation of appropriate arrangements with port operators and thinking through supply chain, installation and assembly issues, including cabling and jack-up vessel availability.

However, port area projects face a number of constraints, including limitations on installed capacity (due to competing demands for space) and lower energy yield (due to inferior wind quality). The ultimate goal is therefore to develop large-scale open water OSW projects, initially using fixed-foundation turbines. Since Japan has relatively few shallow water sites suitable for fixed-foundation turbines, over the longer term it is expected that floating technology (which has yet to achieve maturity and full commercial viability) will be required to harness the full potential of Japan's OSW resources.

CATALYTIC REGULATORY CHANGE

Given the current state of play set out above, the coming into effect on 1 April 2019 of the Act for Promoting Utilization of Sea Areas in Development of Power Generation Facilities Using Maritime Renewable Energy Resources (Act No. 89 of 2018) (the OSW Promotion Act) is a major step forward for the development of the OSW sector in Japan.

Pursuant to the OSW Promotion Act, the government will designate certain "promotion areas" in Japanese territorial open waters and initiate a bidding process for the development of OSW projects in those promotion areas. Winning bidders will acquire certain rights of occupation in respect of the relevant promotion area for up to 30 years. Winning bidders will also obtain certification under the Japanese feed-in-tariff (FIT) regime. As the OSW

Key issues

- The OSW Promotion Act provides certainty on long-term occupation rights and the FIT certification for offshore wind projects in Japanese territorial open waters.
- The government will designate certain "promotion areas" in Japanese territorial open waters and initiate a bidding process for the development of OSW projects in those promotion areas.
- While the OSW Promotion Act is encouraging in terms of the bankability of open water OSW projects in Japan, challenges remain, such as grid connection and the environmental impact assessment process.
- Industry participants, in dialogue with governmental agencies, will play a key role in creating and sustaining an accommodating environment for the development of the open water OSW sector in Japan.

Promotion Act provides certainty on long-term occupation rights and the FIT certification, the OSW Promotion Act is expected to stimulate significant investment in the sector.

The OSW Promotion Act does not specify the number of promotion areas to be designated, their locations or a target total installed capacity. However, the government has separately indicated that it would seek to designate five promotion areas for development by 2030. While it has not set a firm installed capacity target for OSW projects, it has expressed the intention to increase aggregate installed capacity for all wind power projects (both onshore and offshore) to approximately 10GW from the current level of approximately 3.6GW within the same timeframe. Against a backdrop of small annual increases in new wind power generation capacity in Japan, the OSW Promotion Act is therefore widely expected to jumpstart investment in the sector by paving the way for larger and more bankable projects.

PROMOTION AREAS

The OSW Promotion Act enables the Ministry of Economy, Trade and Industry (METI) and the Ministry of Land, Infrastructure and Transport (MLIT) to designate promotion areas. METI and MLIT are expected to designate up to five promotion areas for development by 2030.

The government will engage in a consultation process before designating the promotion areas, involving stakeholders such as local industry groups (primarily fishing associations), academic experts and local governments. In choosing the promotion areas, METI and MLIT are also expected to consider a number of critical issues including climate and subsea characteristics, transportation requirements, effects on shipping routes and fishing activities, environmental impact and grid connection.

TENDER GUIDELINES

After designating the promotion areas, METI and MLIT are expected to publish guidelines setting out in detail the competitive tender process for the development and operation of open water OSW farms in those areas. METI and MLIT have released a briefing outlining the envisaged steps in the tender process.¹

The guidelines will set out, among other things, the bidder eligibility requirements and the assessment criteria. Among the assessment criteria, the FIT proposed by bidders is likely to be the single most highly weighted factor and could account for up to half of the total scoring. Under Japanese law the maximum FIT for OSW is currently fixed at JPY 36/kWh.

The remaining assessment criteria will focus on the capacity of the bidder to develop and operate a long-term, stable and efficient power generation business. This capacity may be demonstrated through a track record of experience in OSW projects, supply chains and financial conditions, a constructive relationship with the local government, local benefits (including job creation and other measures of positive economic impact) and coordination with the fishing industry.

Bidders will be expected to nominate the installed capacity of the OSW farm, which must be within +/- 20% of the amount envisaged by METI and MLIT for

¹ https://www.enecho.meti.go.jp/category/saving_and_new/new/new/information/190611a/pdf/operation.pdf

the relevant promotion area, and will be subject to discussions with the regional utility company to take account of grid constraints.

Bidder eligibility requirements are likely to cover both technical matters (e.g. experience and reputation in power generation including OSW) and financial matters (e.g. financing by banks with OSW experience). Further, it has been proposed that only Japanese entities should be permitted to participate in the tender process. International operators would therefore need to bid through their Japanese subsidiaries or a project company incorporated with a Japanese partner. While there are currently no statutory restrictions on foreign ownership, it is being discussed whether foreign investors ought to be permitted to hold a majority share in a project company.

Successful bidders will be awarded a 30-year permit to develop, own and operate an OSW farm in the relevant promotion area.

CHALLENGES REMAIN

While the OSW Promotion Act is encouraging in terms of the outlook for open water OSW projects in Japan, challenges remain.

The 30-year occupancy right granted to a successful bidder will take the form of a government permit which does not provide an exclusive right of occupation and access to the project area, unlike a leasehold interest. Additionally, no security interest can be taken over the permit. This restriction is, however, not unique to OSW projects in Japan, and in other jurisdictions (such as the UK) lenders have been able to take comfort from the fact that no party is able to take security over a permit. Indeed, the unavailability of security over a range of assets has not proven fatal to the bankability of projects in other jurisdictions. In Taiwan, security cannot be taken over the power purchase agreement or certain permits - this did not prove to be a bar to bankability in Formosa 1.

Lack of certainty regarding grid connection also remains a key challenge. A tender winner is not guaranteed to obtain grid connection with a local utility company. While the Japanese government is promoting a 'connect and manage' approach to optimise network usage and enhance grid access for new renewable power projects, no details have been released around how the costs of grid expansion and upgrade works will be allocated.

For developers who are already engaged in early stage development works on open water OSW projects, the consequences of their proposed project site subsequently being designated a promotion area are a potential cause for concern. There is no guarantee that these developers will win the tender process for the relevant promotion area, though they should have a competitive advantage as a result of the pre-development works (such as site surveys, environmental assessments and wind studies) that they would have already carried out. Such risk may also be mitigated by taking the requirements of the tender assessment into consideration from an early stage of project planning.

The environmental impact assessment process also represents a major challenge to new OSW projects. Although a development plan submitted in the tender process may need to identify measures to address environmental concerns, an environmental impact assessment is not included in the tender process under the OSW Promotion Act and must be undertaken separately. In Japan, this can take a significant amount of time – around four years.

The tender process in Japan is also likely to require bidders to include a plan outlining their approach to decommissioning and removal of the facility at the end of its useful life and the sources of funding for decommissioning works. There are indications from METI that developers may be able to rely on third-party guarantees to secure the removal costs, as is the case in other jurisdictions, such as Germany.

TAKING A BROADER VIEW

Clearly challenges remain for the development of open water OSW projects in Japan. Industry participants, in dialogue with METI, MLIT and other relevant agencies, will play a key role in creating and sustaining a fertile environment for the development of the open water OSW sector in Japan.

Experience has shown that imperfections in the regulatory structure need not be an insurmountable challenge, particularly if a broader view of the regulatory landscape and market can legitimately be taken into account.

On the Formosa 1 project, working closely with the sponsors, Clifford Chance successfully navigated the Taiwanese legal and regulatory framework in order to overcome bankability challenges with the template Taiwan OSW power purchase agreement. A similar degree of creative thinking may be required in Japan.

In addition, market-specific fundamentals can be used to the benefit of the sector. For instance, Japanese contractors tend to be willing to accept greater aggregation of construction packages compared to their international peers. Again, working closely with the sponsors on Formosa 1, we were able to achieve levels of aggregation comparable to, or better than, that seen in the mature European OSW market.

Our offering: unique APAC OSW experience combined with strong Japanese domestic projects capabilities

Clifford Chance has a market-leading track record advising on OSW in Asia Pacific.

This includes:

- **Formosa 1 Project, Taiwan:** advised Macquarie, Ørsted and Swancor on the development of the 128MW Formosa 1 Project, Taiwan's first commercial scale offshore windfarm and Asia Pacific's first project financed OSW project (*IJGlobal Asia Pacific Offshore Wind Deal of the Year 2018* and *PFI Asia Pacific Renewables Deal of the Year 2018*).
- **Formosa II Project, Taiwan:** advising the sponsors on the development of this 376MW OSW project.
- **Yunlin Project, Taiwan:** advised an investor on its bid to acquire a significant equity stake in this 640MW OSW project.

In Japan, Clifford Chance is actively advising developers and financiers on significant inbound infrastructure and renewable power projects.

The Clifford Chance Tokyo office is praised by clients for the quality of our Japan-based lawyers and our ability to draw upon the vast strength of our international network to deliver technical excellence combined with market expertise and commercial pragmatism. We are regularly acknowledged for our skill in structuring and executing complex infrastructure and renewable energy transactions and have won numerous awards over the years, including **Finance International Firm of the Year 2019** and **Client Service Firm of the Year 2019** at the Chambers Asia-Pacific Japan Awards and **Project Finance Deal of the Year 2019** and **International Deal Firm of the Year 2016** at the ALB Japan Law Awards.

KEY CONTACTS

We have a deep bench of Asia Pacific-based lawyers with hands-on OSW experience. Our team is fully integrated and having our Japanese law and foreign law qualified lawyers working side-by-side on infrastructure and renewable energy projects ensures that we are familiar with both local and international legal and business practices. This approach gives us a unique ability to assist investors on OSW projects in Japan. Please contact any of the lawyers below to discuss further how we can support you.



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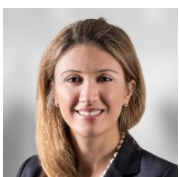
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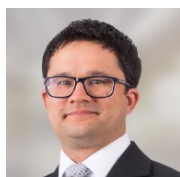
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