JONES DAY

AUGUST 2013

RENEWABLE ENERGY IN JAPAN: ONE YEAR AFTER THE IMPLEMENTATION OF THE FEED-IN TARIFF LAW

In the year since the Act on Special Measures Concerning the Procurement of Renewable Energy by Operators of Electric Utilities (the "Act") became effective, Japan's renewable energy market has developed rapidly as a result of the feed-in tariff system for renewable energy projects, notwithstanding numerous issues and challenges.

Last year, we provided an overview of the feed-in tariff system and key provisions of the Act ("**Japan Launches the Feed-in Tariff System for Renewable Energy**," *Jones Day Commentary*, July 2012). This *Commentary* addresses some of the significant developments and issues that have arisen in the course of the implementation of the Act during the past year.

CERTIFIED RENEWABLE ENERGY FACILITIES

To qualify for the purchase price and purchase period that the Ministry of Economy, Trade and Industry ("METI") set for fiscal year 2012 under the Act, renewable energy projects required (i) certification by METI as a "certified facility" and receipt by a power utility of a written request for interconnection from the generator of such facility and (ii) that the date of such certification or request (whichever is later) must have fallen between July 1, 2012 and March 31, 2013. According to METI, the aggregate amount of power capacity represented by facilities that either commenced operation or became a certified facility under the Act as of February 2013 is set forth below. More than 90 percent of the energy source represented below is solar power.

	Aggregate capacity of facilities that commenced operation during the period from April 2012 to February 2013	Aggregate capacity of facilities that became a certified facility by February 2013
Solar (residential)	1,137,000 kW	1,246,000 kW
Solar (nonresidential)	422,000 kW	11,012,000 kW
Wind	63,000 kW	622,000 kW
Small or Mid-Sized Hydro (1,000 kW or more)	1,000 kW	23,000 kW
Small or Mid-Sized Hydro (less than 1,000 kW)	2,000 kW	5,000 kW
Biomass	36,000 kW	147,000 kW
Geothermal	1,000 kW	4,000 kW
Total	1,662,000 kW	13,059,000 kW

(Source: METI)

PURCHASE PRICE AND PURCHASE PERIOD FOR FISCAL YEAR 2013

METI has now announced the following purchase price (tax inclusive) and purchase period for renewable energy projects that satisfy the certification and interconnection request requirements for fiscal year 2013:

Power Source	Purchase Price	Purchase Period
Solar (10 kW or more)	37.8 Yen/kWh	20 years
Solar (less than 10 kW)	38 Yen/kWh	10 years
Wind (20 kW or more)	23.1 Yen/kWh	20 years
Wind (less than 20 kW)	57.75 Yen/kWh	20 years
Hydro (1,000kW–30,000kW)	25.2 Yen/kWh	20 years
Hydro (200kW–1,000kW)	30.45 Yen/kWh	20 years
Geothermal (15,000kW or more)	27.3 Yen/kWh	15 years
Geothermal (less than 15,000kW)	42 Yen/kWh	15 years
Biomass (methane)	40.95 Yen/kWh	20 years
Biomass (unused trees)	33.6 Yen/kWh	20 years
Biomass (other than unused trees)	25.2 Yen/kWh	20 years
Waste Construction Materials	13.65 Yen/kWh	20 years
General Waste	17.85 Yen/kWh	20 years

METI established the purchase price for fiscal year 2013 with input from the committee established by METI pursuant to the Act for the assessment of the purchase price and other factors. The purchase price for fiscal year 2013 applicable to solar projects with a capacity of 10kW or more is 37.8 Yen (tax inclusive), as compared to 40 Yen for fiscal year 2012. In setting the purchase price for fiscal 2013, METI received public comments arguing that the purchase price for solar projects should remain the same as that for fiscal year 2012. In response, METI noted that the purchase price for fiscal year 2013 would be lowered to reflect the reduced costs of solar projects, including the prices of panels, power conditioners, and cradles as well as workers' wages, all of which have decreased compared to those that were in effect when the purchase price for fiscal year 2012 was determined.

METI MODEL POWER PURCHASE AND INTERCONNECTION AGREEMENT

Power utilities are required under the Act, if requested by a generator, to enter into an agreement on the supply and purchase of power generated by a certified facility, unless a statutory exemption applies. Unfortunately, the lack of a standard power purchase agreement for renewable energy that was generally acceptable to market participants, including providers of financing for renewable energy projects, meant that each utility published its own form of power purchase agreement, often with terms unduly favorable to the utility and inconsistent with the requirements of the Act. To address this issue, in September 2012 METI released a Model Contract Form for Specified Agreement/ Interconnection Agreement (the "METI Model Agreement") to serve as a model power purchase and interconnection agreement. This model agreement assumes that (i) the power purchaser and interconnection provider are the same utility company; (ii) the power generating facility is a certified facility for either solar or wind power with a capacity of more than 500kW; (iii) the parties will enter into the agreement before construction of the certified facility; and (iv) the power generator expects to obtain financing for the project.

Since the release of the METI Model Agreement, utility companies and renewable energy power producers have raised a number of questions on the METI Model Agreement. In June 2013, METI sought to address some of these questions with a commentary on the METI Model Agreement. The commentary provides, in part:

- The renewable energy power producer must maintain the METI facility certification throughout the contract term. Under the METI Model Agreement, the agreement terminates if such certification is revoked or is no longer in effect for any reason. METI notes that the provisions are consistent with the facility certification condition precedent for the utility company to be required to interconnect facilities under the Act. Thus, METI explains that if a utility company procures electric power from a renewable energy power producer that does not have METI facility certification, the utility may not pass on any portion of the purchase price paid to such renewable energy power producer to the utility's customers.

- Costs for interconnection construction work must be borne by the renewable energy power producer. METI points out that under the Act, the utility company may deny interconnection if a renewable energy power producer does not bear the costs and fees for interconnection work. Although METI recognizes the negotiability of this provision under the METI Model Agreement, as a practical matter it seems unlikely that a utility company would agree to delete this provision as it directly reflects the provisions of the Act.

- The utility company must notify the renewable energy power producer and may request an extension of the work period, without compensation, if the scheduled completion date for interconnection construction work is delayed due to an act of God or any other reason not attributable to the utility company. Such extensions often occur when the utility company is unable to obtain the consent from the affected landowner to the easement for the transmission line, and such delay typically results in a delay in start-up of operation for a year or more.

- The renewable energy power producer must pay the amount of the over-run if there is a cost over-run for the interconnection work, unless (i) the over-run is attributable to the utility company or (ii) reasonable grounds exist for the renewable energy power producer to refuse to pay such amount. One example of what may constitute such reasonable ground for refusal is a case where the increased cost does not have a reasonable basis. METI notes, however, that the failure of the renewable energy power producer to obtain consent from its lender(s) to pay such amount does not constitute a reasonable ground for refusal.

DELAY IN COMMENCEMENT OF OPERATION

As noted above, solar projects represented the vast bulk of renewable energy projects qualifying for the purchase price applicable to fiscal year 2012. Most of these projects (especially nonresidential solar) have been certified by METI but have not yet commenced operation. Commentators suggest that one reason for such delay in operation is that a sharp increase in demand for solar panels and power conditioners has resulted in delay in delivery. Others observe that certain developers and brokers, with no intention of operating a renewable energy facility, nevertheless obtained a METI facility license in order to lock in the high purchase price applicable to fiscal year 2012, with a view to selling rights to such facility to a third-party investor. In these cases, developers or brokers obtained METI facility certification using land that was difficult to develop due to geological conditions or regulatory requirements. Although the application for METI certification requires the designation of a scheduled start-up date, at present, delays in the commencement of operation do not affect the validity of the facility certification and require no notice of change in the start-up date. METI is currently considering whether to change this practice and potentially withdraw facility certifications where the facility does not commence operation within a year of the date of certification. In addition, METI is also considering withdrawing facility certifications and effectively changing the applicable purchase price for certified facilities if there is a change in the type or supplier of panels or power conditioners that were specified in the application for certification.

CURTAILMENT OF POWER OUTPUT

The Act sets no limit on the total amount of power a power utility is required to purchase from a certified facility. Even before the Act's implementation, concerns existed around the possibility of oversupply and the resulting burden on a utility's electricity grid. The Act permits a power utility to instruct a power generator to restrain output without compensation under certain circumstances, including for a period of up to 30 days if the estimated supply of power exceeds demand despite certain countermeasures taken by the utility. In addition, if interconnection is reasonably expected to exceed a utility's transmission capacity or receptive capacity, the Act permits the utility to refuse interconnection subject to certain requirements.

The issue of oversupply has been particularly acute in Hokkaido, where the availability of land has attracted many developers. In December 2012, METI ordered the regional utility, Hokkaido Electric Power Co., Inc. ("HEPCO") to consider ways to increase interconnection capacity as it appeared likely that the interconnection capacity required for facilities seeking certification and interconnection to HEPCO's grid (around 400,000 to 600,000 kW) was likely to exceed actual capacity. In April 2013, METI announced the following measures relating to HEPCO:

- Amendment of the Act to permit a power utility located in an area that does not have sufficient interconnection capacity to ask certified facilities to curtail power output without limitation or compensation, subject to the requirement that the utility disclose its forecast of the duration and extent of any such curtailment. This amendment applies only to HEPCO and solar power facilities expected to generate 500kW or more in the areas covered by HEPCO after the aggregate capacity for such solar power facilities exceeds 700,000 kW. The effective date of this proposed amendment has not been announced.

- Separately, HEPCO is already experiencing difficulty in providing interconnection to certified facilities, especially those with a capacity of 2,000kW or more. As of April 2013, the aggregate interconnection requirement of such facilities reached 400,000kW, which is the maximum interconnection capacity of HEPCO. METI has therefore confirmed that, under such circumstance, HEPCO may deny applications for interconnection pursuant to the Act. In the meantime, HEPCO is considering installing large-scale storage batteries (with a capacity of approximately 60,000 kW) to expand its interconnection capacity, and once installed, these storage batteries are expected to increase HEPCO's interconnection capacity by 10 percent.

On April 2, 2013, the Cabinet of Prime Minister Shinzo Abe endorsed the Electric System Reform Plan that is intended to strengthen the transmission infrastructure and adjustment function for electricity supply and demand in Japan. Implementation required an amendment to the Electricity Business Act that was expected during the most recent session of the Diet, but it was not adopted, thereby resulting in further delay in necessary reforms to the electricity system in Japan.

CONCLUSION

The Japanese renewable energy market has enjoyed substantial growth since the implementation of the Act, as evidenced by the number of facilities certified by METI and the aggregate amount of power generating capacity represented by these facilities. At the same time, the relatively small number of facilities that actually commenced operation underscores the challenges for renewable energy projects even after the METI certification process is completed. In consultation with market participants, METI sought to address some of these issues and challenges, but capacity limitation for interconnection remains an overriding issue in some areas. Addressing this challenge will require action by METI and, ultimately, the implementation of a coordinated and comprehensive reform program by the Japanese Government.

LAWYER CONTACTS

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