



Japan Expands Renewable Energy Program, Tightens Requirements for Renewable Energy Projects

Japan's Cabinet recently approved a series of amendments (the "Amendments") to the Act on Special Measures Concerning the Procurement of Renewable Energy by Operators of Electric Utilities (the "Act"),¹ which, when approved and implemented, are likely to have a significant effect on the feasibility and profitability of current and future renewable energy projects. The impacts on developers will include: (i) increasing pressure to conclude interconnection agreements with utility companies as quickly as possible to obtain facility certification by the Ministry of Economy, Trade, and Industry ("METI") and to secure a favorable purchase price; (ii) requiring detailed and comprehensive plans for project development at the time of facility certification, with disincentives for amending such plans after a project has been certified; and (iii) requiring developers of ongoing projects to review existing agreements with utility companies to ensure compliance with the Amendments.

This *Commentary* provides a summary of the Amendments, particularly as they affect current and future solar projects in Japan.

Background

Almost four years have passed since the implementation of the feed-in tariff system promoting renewable energy in Japan, which was created by the Act. At the same time, the energy market in Japan has been undergoing structural reform aimed at greater liberalization and increased competition, while simultaneously securing the stable supply of electricity in Japan through the implementation of a series of amendments to the Electricity Business Act.² In July 2015, the Japanese government confirmed that renewable energy must constitute a significant part of Japan's long-term energy plan, with the goal of 22–24 percent of Japan's energy sources in 2030 being renewable

1 "Japan Launches the Feed-in Tariff System for Renewable Energy," *Jones Day Commentary*, July 2012; "Renewable Energy in Japan: One Year After the Implementation of the Feed-in Tariff Law," *Jones Day Commentary*, August 2013.
2 "Japan Approves Final Set of Power Market Reforms," *Jones Day Commentary*, August 2015.

energy. To promote this objective, while also addressing concerns about costs passed onto the public and solar projects that fail to commence operation, the Cabinet approved the Amendments on February 9, 2016, for submission for approval by the 190th ordinary Diet session. If approved, the Amendments are expected to become effective on April 1, 2017 (except for certain provisions relating to tax exemption that are expected to become effective on October 1, 2016) and will result in significant changes to Japan's feed-in tariff system.

The Amendments have three general purposes: (i) to promote the Japanese government's goal of increasing renewable energy's share of Japan's energy sources, from 12.2 percent³ in fiscal year 2014 to 22–24 percent in fiscal year 2030; (ii) to reduce the cost of electric power, including the costs associated with renewable energy that are passed onto consumers; and (iii) to achieve the effective distribution of electric power in Japan in accordance with the amendments to the Electricity Business Act. To further these objectives, the Amendments introduce a new facility certification system and measures to ensure effective implementation of renewable energy projects. Existing projects that have obtained facility certification under the Act prior to the effective date of the Amendments will also be required to obtain certification under the new system, subject to a transitional period for projects that have completed interconnection. How the new facility certification requirement will affect such existing projects, however, remains unclear. The detailed implementation ordinance or guidelines for the Amendments are likely to be issued once the Amendments pass the Diet.

Current Facility Certification System

For a renewable energy project to qualify for the purchase price and purchase period that METI sets for each fiscal year under the Act: (i) the power generating facility must have been approved by METI as a "certified facility," and a power utility must have received a written request for interconnection from the owner of such facility; and (ii) the date of such certification or request (whichever is later) must fall between April 1 and March 31 of such fiscal year. The purchase price

established by METI generally is intended to reflect the costs of developing a renewable energy project. As these costs generally have declined with respect to solar projects, the purchase price established by METI for each fiscal year also has been declining.

In January 2015, METI revised the certification criteria for solar projects seeking facility certification after April 1, 2015 and announced that the applicable purchase price and purchase period will be determined at the time the project company enters into the interconnection agreement with the relevant utility (and not at the time of application for interconnection). METI also amended the applicable rules to provide that if, after February 15, 2015, there are any changes in the power-generating capacity or in the basic specifications of the solar cell modules (such as the manufacturer or conversion rate) to be used in solar projects having received METI facility certification, the applicable purchase price and purchase period will be changed to those in effect during the fiscal year in which the project company submits the application for such changes. If there is an increase in the power output of an operational facility, the project company must obtain a new facility certification from METI for that part of the facility generating the increased output, and the purchase price and purchase period in effect during the fiscal year in which METI issues such new facility certification will apply to such increased output. The revised standards are intended to remedy situations where developers obtained METI facility certification to ensure a favorable purchase price but failed to proceed promptly with project development and operation. Because utilities generally must accept requests for interconnection by developers, undeveloped solar projects have limited access by new developers to the grid system and restricted the use of power generated through renewable energy sources.

New Facility Certification System

Renewable energy projects seeking METI facility certification after April 1, 2017 will be subject to a new certification system. Before issuing facility certification for a project, METI will confirm the feasibility of the project. The standards for METI's

³ Excluding hydropower, this percentage is 3.2 percent.

confirmation of feasibility remain unclear; however, when a developer applies for METI facility certification and provides the required information, METI is expected to issue facility certification only if the project plan can be implemented smoothly and with certainty (for example, by confirming the interconnection arrangement for the project). Under this new system, information relating to certified projects will be made publicly available, and METI will have the authority to issue improvement orders or cancel the facility certification for projects that METI deems not in compliance with the project plan or not implemented as originally scheduled. These measures are intended to ensure that certified projects have a high likelihood of timely development and operation pursuant to a reasonable project plan. In addition, METI intends to ensure that the development of such projects will comply with applicable legal and regulatory requirements, particularly with respect to safety and environment, and METI will penalize any developer that fails to adhere to such requirements.

Determination of Purchase Price

Pursuant to the Amendments, METI will announce mid- to long-term targets for the applicable purchase price for certain categories of renewable energy sources deemed to require significant lead time for development and operation, such as wind, geothermal, mid- to small-scale hydro, and biomass. The purchase price for large-scale solar projects will continue to be set annually. METI expects that the purchase price targets will ensure a certain level of predictability for projects that require a lengthy period for approval, construction, and interconnection, thereby encouraging developers to proceed with such projects.

The Amendments also will introduce a bidding system for projects designed to reduce the applicable purchase price by promoting competition among power suppliers. This system is modeled after a system adopted by Germany with respect to its solar projects. Initially, METI is expected to apply this bidding system, under which applicants for facility certification essentially bid for the lowest purchase price, to business-purpose large-scale solar projects. Under the Amendments, METI also may decide to apply the bidding system to other types of renewable energy projects. METI will determine the renewable energy source and the project size to which the bidding system will apply, and it will provide

guidelines for its implementation, taking into account input from METI's Purchase Price Calculation Committee. In such guidelines, METI is expected to provide details necessary for the implementation of the bidding system, such as the applicable renewable energy source, power output capacity of the power-generating facility, standards for the participants in the bidding, the method to determine the purchase price based on bidding, the deadline for the successful bidder to apply for METI facility certification, and the purchase period to be applied. The participants in the bidding will submit their project plans to METI, and the plans also will be used for application for METI facility certification.

Purchaser of Renewable Energy

Consistent with the amendments to the Electricity Business Act, which, among other things, require regional utilities to separate their electricity distribution and transmission business from their generation and retail businesses, the Amendments will specify that the purchasers of power generated by a certified renewable energy project will be distribution and transmission companies. This change will require amending existing power purchase agreements with utilities, which will designate their distribution and transmission companies that will act as the purchaser thereunder.

Conclusion

The Amendments, when approved and implemented, are likely to have a significant effect on the feasibility and profitability of current and future renewable energy projects. Developers will be under increased pressure to conclude interconnection agreements with utility companies as quickly as possible to obtain METI facility certification and to secure a favorable purchase price. Developers also will be required to provide detailed and comprehensive plans for project development at the time of facility certification, and they will have a disincentive for amending such plans after a project has been certified. Developers of ongoing projects will need to review existing agreements with utility companies to ensure compliance with the Amendments. As details of the implementation of the Amendments are reviewed and addressed by various committees of METI in the next several months, developers of ongoing and future renewable energy projects in Japan carefully should consider the effects of the Amendments on such projects.

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