



Carrots and FITs: Japan's drive for renewables

The Japanese government wants to encourage generation from renewables, and has followed the lead of the British, German, Spanish and Italian governments in establishing a feed in tariff (FIT) regime as a stepping-stone to unsubsidised renewable energy generation in the future. The FITs, brought in under the Act on Special Measures Concerning the Procurement of Renewable Electric Energy by Operators of Electric Utilities (the *Act*) and managed by the Ministry of Economy, Trade and Industry (*METI*), are among the highest in the world and have encouraged early participation in the regime's first year, which ends on 31 March 2013.

FIT: procedure and pass-through

- A renewable energy operator (*Operator*) seeking to qualify for FITs will first need to obtain certain plant approvals from the Minister of Economy, Trade and Industry (the *Minister*).
- Once it has the Minister's approval, it may then force a regional utility (*Utility*), such as TEPCO or KEPCO, to enter into a power purchase agreement (*PPA*), which reflects the procurement period and the FIT price set by the Minister (and subject to certain conditions – for example the Operator agreeing to allow the Utility access to its electric meters and the agreement being written in Japanese and subject to Japanese jurisdiction and law).
- The Utility must also enter into an interconnection agreement (though the Act gives Utilities certain limited refusal rights, including when there is a reasonable prospect of over-capacity of interconnection).
- The Utility will then be able to pass on some of the costs to end-users via a surcharge price which is set annually by the Minister.

FIT: annual rates and terms

The FIT rates and their payment terms is determined annually by the Minister for each fiscal year. In setting the price and term, the Minister must consult with a specially established FIT Committee and consider the opinions of other ministers. The Minister must also take into account several factors when setting the FIT price, including:

- operator profitability (and for the first three years after the Act comes into effect, special consideration must be given to the aim of enticing investment);
- the total capacity of renewable power generation in Japan at the time;
- anticipated energy generation costs; and
- the burden that the surcharge will have on end-users.

Generally speaking, the pricing is locked-in for the term of the PPA, and any changes in the FIT rates or payment terms determined by the Minister will only apply to agreements entered after the new rates and duration have been set. However, under the Act, the Minister does have power to change the FIT rates in very limited circumstances. METI has said that in the absence of significant unforeseen economic changes, such as drastic inflation or deflation, the Minister will not exercise its right to amend the FIT rates. To date investors have been willing to take this risk, as it does not seem to have curtailed enthusiasm for investment in renewables.

Current FIT rates and term

To qualify for the first year FIT rates, after obtaining the required Minister's approval the Operator must have made a written offer to a Utility to enter into an interconnector agreement by 31 March 2013. The FIT rates and payment terms set by the Minister for 2012 is set out below – note the FIT rate for solar which was higher than expected.

Rates after April 2013

The current FIT rates, aimed at encouraging aggressive investment into renewable energy, are set to expire on 31 March 2013, and many are wondering what will happen to the rates next April. The FIT rate for solar energy has received the most attention and also much criticism for being too high - including from a member of the FIT Committee, who at the time this year's FIT rates were set expressed surprise at the solar rate being higher than expected². The Keidanren,

FIT rates to 31 March 2013

Geothermal		15,000kW or more		Under 15,000kW	
FIT rate		27.3Yen		42Yen	
Term		15 years		15 years	
Wind		20kW or more		Under 20kW	
FIT rate		23.1Yen		57.75Yen	
Term		20 years		20 years	
Solar	10kW or more	Under 10kW	Under 10kW (cogeneration with private power plant)		
FIT rate	42Yen	42Yen	34Yen		
Term	20 years	10 years	10 years		
Hydroelectric	1,000kW or more to under 30,000kW		200kW or more to under 1,000kW	Under 200kW	
FIT rate	25.2Yen		30.45Yen	35.7Yen	
Term	20 years		20 years	20 years	
Biomass	Methane fermentation gasification power generation	Unused wood combustion power generation	Wood combustion power generation	Water material (excluding wood) combustion power generation)	Recycled wood combustion power generation
FIT rate	40.95Yen	33.6Yen	25.2Yen	17.85Yen	13.65Yen
Term	20 years	20 years	20 years	20 years	20 years

Source: METI website

Japan's most powerful business lobby, also suggested that they may not support the continued use of the FIT when they announced their view that 'there should be a regular review of the program including the possibility of scrapping the program'.

So it seems likely that the FIT rates for solar will drop next April, but so far there is little visibility as to the extent of the adjustment and whether the other FIT rates will be affected.

Project finance promoted

Previously, Utilities rarely allowed Operators to create a security interest for lenders over a PPA. The Minister, however, has moved away from this position and has provided in the standard form PPA and interconnector agreement it has issued for use when project finance is contemplated, that a lender can create a security interest over the PPA, and a Utility may not reject entering into the PPA for that reason. Note that this standard form does not sufficiently protect lenders' interests to internationally accepted standards, so tailor made amendments and negotiations will be necessary. However, it is still noteworthy that METI led this market change in an attempt to change the dynamics between Utilities and Operators.

Solar bubble?

Bloomberg recently reported that 'While Government data show that Japan can build wind farms at a cheaper price and with higher returns than solar, 99 per cent of applications for the new tariffs are for electricity generated from sunlight'¹. According to that same Bloomberg article, in a 7 September interview Summit Energy President Shinichi Kitamura observed that 'With so many companies rushing in we are seeing a solar bubble forming'. This solar bubble, combined with the massive space requirements that solar energy plants require, are sending land prices soaring. This has created an unusual cast list of renewable energy converts ranging from investors holding distressed Japanese real estate (including golf courses) to local governments with unused acreage intended for industrial development. Apart from the utility scale solar, investors are also exploring expansion of the rooftop solar energy market.

¹
Sumitomo Sees 'Solar Bubble' as Japan Rejects Nuclear: Energy, Bloomberg Businessweek, Yuriy Humber and Tsuyoshi Inajima, 1 October 2012

²
As noted in the minutes of the 5th FIT Committee

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