

Renewable Energy 2020

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Renewable Energy

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Contributing editor**Eric Pogue**

Hunton Andrews Kurth LLP

Lexology Getting The Deal Through is delighted to publish the third edition of *Renewable Energy*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

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Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editor, Eric Pogue of Hunton Andrews Kurth LLP, for his continued assistance with this volume.



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MARKET FRAMEWORK

Government electricity participants

- 1 | Who are the principal government participants in the electricity sector? What roles do they perform in relation to renewable energy?

The principal government participants in Japan are the Ministry of Economy, Trade and Industry (METI) and its affiliated agency, the Agency for Natural Resources and Energy.

These authorities are in charge of enforcing the laws and regulations with respect to the energy business, including the electricity generation business from renewable energy sources. In addition, these authorities are in charge of implementing the feed-in tariff (FIT) programme in Japan and issuing certificates that make renewable energy projects eligible for mandatory power purchase arrangements under the FIT programme.

Private electricity participants

- 2 | Who are the principal private participants in the electricity sector? What roles do they serve in relation to renewable energy?

There are 10 major vertically integrated electric power utilities in Japan, each of them covering a different area of the country. The electricity transmission business is dominated by these 10 utility companies, which also take up a large share of the electricity generation business and electricity retail business.

Regarding electricity generation, in addition to the vertically integrated utilities that are involved in electricity generation business, there are a number of independent power producers in Japan such as trading companies and affiliates of investment funds. Since the commencement of the FIT programme in Japan in 2012, foreign investors have also participated in renewable power generation projects.

The electricity retail business has been fully liberalised since April 2016. Although vertically integrated utilities are still the dominant players in the market, various types of non-utility electricity suppliers are increasing their market share.

Definition of 'renewable energy'

- 3 | Is there any legal definition of what constitutes 'renewable energy' or 'clean power' (or their equivalents) in your jurisdiction?

Under the Act on Special Measures Concerning the Procurement of Renewable Electric Energy by Operators of Electric Utilities (the Renewable Energy Act), which is in charge of the implementation of the FIT programme in Japan, renewable energy is defined as solar power, wind power, hydraulic power, geothermal heat and biomass.

There are statutes that have a broader definition. For example, under the Act on the Promotion of Use of Non-Fossil Energy Sources and Effective Utilization of Fossil Energy Materials by Energy Suppliers, renewable energy includes solar heat and other sources of natural heat, such as the heat in the air, in addition to solar power, wind power, hydraulic power, geothermal heat and biomass.

Framework

- 4 | What is the legal and regulatory framework applicable to developing, financing, operating and selling power and 'environmental attributes' from renewable energy projects?

The legal framework generally applicable to selling power from renewable energy projects is the FIT programme under the Renewable Energy Act. Under the FIT programme, the owner of a renewable energy project with a certification from METI has the right to request a transmission utility to enter into a power purchase agreement with it and purchase all available electric power at a fixed price (ie, a price set by METI depending on the type of renewable energy source and the output capacity of the project) over a long term (ie, 10, 15 or 20 years depending on the type of renewable energy source). A transmission utility is required to accept such requests unless there is a legitimate reason not to. Legitimate reasons are strictly limited by and defined under the Renewable Energy Act. The utilities that are required to purchase electric power from renewable energy projects have the right to receive a renewable energy subsidy, the cost of which is ultimately borne by the end users who are required to pay renewable energy surcharges under the FIT programme.

The development, financing and operation of renewable energy projects are subject to other general laws and regulations governing each area. Regarding permission for development, some local governments impose specific regulations on the development of renewable energy power plants.

Regarding environmental attributes from renewable energy projects, the following programmes represent the main legal and regulatory framework.

J-Credit

If an entity reduces its emissions of greenhouse gas or increases its absorption of greenhouse gas by introducing energy-saving equipment, providing forest management or the like, along with fulfilling certain criteria, such reduction of emissions or increase in absorption of greenhouse gas can be certified as J-Credit. A holder of J-Credit can sell it to a third party.

Green power certificate

If an entity introduces a renewable energy power project, along with fulfilling certain criteria, the increase in environmental value from the power generation from such renewable energy project can be

certificated into a green power certificate. The initial holder of a green power certificate can sell it to a third party, but the purchaser from the initial holder cannot resell the certificate.

Certificate of non-fossil fuel value

A Non-Fossil Fuel Certificate was introduced in 2018. The Certificate, which embodies the zero-emission value created by a renewable project under the FIT programme, is issued by a governmental agency and sold to electricity retailers at auction. The scope of electricity generators eligible to receive the Non-Fossil Fuel Certificate is expected to be expanded in November 2019 to cover the 'post-FIT' non-fossil fuel power generation, and is also expected to be expanded in April 2020 to cover non-fossil fuel power generation outside of the FIT programme. As such, the industry landscape surrounding the Non-Fossil Fuel Certificate may change in the future.

Local cap and trade programme

The cap and trade programme was established in Tokyo metropolitan and Saitama prefectures. Entities in the Tokyo metropolitan area and Saitama prefectures that reduce greenhouse gas emissions can sell the volume of emissions reduced in accordance with the system established by the Tokyo Metropolitan government or Saitama Prefecture.

Nationwide cap and trade programme

There is no cap and trade programme at the national level in Japan.

Stripping attributes

- 5 | Can environmental attributes be stripped and sold separately?

J-Credit, a green power certificate and the environmental attributes under the cap and trade programme in Tokyo and Saitama can be stripped and sold separately.

A purchaser of J-Credit and environmental attributes under the cap and trade programme in Tokyo and Saitama may resell them to third parties. With respect to green power certificates and certificates of non-fossil fuel value, only the initial holder can sell it to a third party, but the purchaser from the initial holder cannot resell it.

Please note, however, that there is currently no active secondary market in Japan for J-Credit and environmental attributes.

Government incentives

- 6 | Does the government offer incentives to promote the development of renewable energy projects? In addition, has the government established policies that also promote renewable energy?

After adopting the Kyoto Protocol, the Japanese government has been promoting the use of renewable energy to reduce greenhouse gas emissions. At one time Japan had an RPS (renewable portfolio standard) programme. Since 2012, however, the FIT programme has replaced the RPS programme and has been bolstering the development of renewable energy projects.

As stated above, the FIT programme, J-Credit, green power certificate, certificate of non-fossil fuel value and the cap and trade programme at the local government level have been established. In addition, the Japanese government also provides tax benefits (such as special depreciation and tax deduction when certain requirements are satisfied) for the introduction of certain energy-saving equipment.

Establishing policies and incentives

- 7 | Are renewable energy policies and incentives generally established at the national level, or are they established by states or other political subdivisions?

METI and its affiliated agency, the Agency for Natural Resources and Energy, establish renewable energy policies and incentives, including the FIT programme, at the national level.

While there is no cap and trade programme at the national level, some local governments have introduced cap and trade programmes.

Purchasing mechanisms

- 8 | What mechanisms are available to facilitate the purchase of renewable power by private companies?

There are no subsidies or other economic incentives to encourage private companies to purchase renewable power. The Japanese government adopted the FIT programme to facilitate the development of the renewable energy sector, and under this programme, an owner of a renewable energy project can sell all available electric power to transmission utilities at a fixed price over a long term (see question 4). The fixed purchase price under the FIT programme is decreasing every year, but since the fixed purchase price is still higher than the market price of electricity, owners of renewable energy projects are generally more inclined to sell electric power to transmission utilities under the FIT programme as opposed to selling to private companies.

Legislative proposals

- 9 | Describe any notable pending or anticipated legislative proposals regarding renewable energy in your jurisdiction.

The current FIT programme is a temporary system intended to encourage introduction of renewable energy resources in Japan, and a revision to the fundamentals of the Renewable Energy Act is expected by 31 March 2021. Although the details of the revision have not yet been determined, the government seems to expect that the solar PV and wind power will be power sources competitive enough to survive in the market without the financial support from the government. The Japanese government is positioning renewable energy as the main source of electricity in Japan, and we need to pay special attention to the upcoming amendment to the FIT programme.

Drivers of change

- 10 | What are the biggest drivers of change in the renewable energy markets in your jurisdiction?

Owing to the shortage of capacity of utilities' transmission and distribution lines, it is increasingly difficult for utility-scale renewable projects to connect to the grid. METI and the Agency for Natural Resources and Energy intend to revise the rules for grid connection by introducing non-firm grid access so that an increased number of renewable projects can access the transmission grid. Under non-firm grid access, electricity power producers can connect to the grid subject to curtailment without compensation in case of network constraints.

Another big driver of change is nuclear power generation. The Japanese government has pledged to reduce its greenhouse gas emissions by 26 per cent by 2030 from the 2013 level, and intends to accomplish this target by increasing the share of renewable and nuclear power in the power generation sector to 44 per cent by 2030. Most of the nuclear reactors have yet to resume operations after the disaster of the Fukushima nuclear power plant in 2011. The longer the operations of nuclear reactors remains suspended, the more renewable energy will be needed to meet the greenhouse gas emissions target.

Disputes framework

- 11 | Describe the legal framework applicable to disputes between renewable power market participants, related to pricing or otherwise.

With respect to disputes regarding utilities' wheeling services and their transmission and distribution lines, the Organization for Cross-regional Coordination of Transmission Operators (OCCTO) was designated as the dispute resolution business operator under the Act on Promotion of Use of Alternative Dispute Resolution. Pursuant to this designation, OCCTO conducts conciliation and mediation proceedings. There is no specific legal framework for resolution for other types of disputes that may arise between or among renewable energy market participants. These disputes are resolved through normal civil judicial proceedings, civil conciliation proceedings or arbitration proceedings.

UTILITY-SCALE RENEWABLE PROJECTS

Project types and sizes

- 12 | Describe the primary types and sizes of existing and planned utility-scale renewable energy projects in your jurisdiction.

After the commencement of the FIT programme in 2012, the number of large-scale solar power projects, such as those with an output of 10MW or more, has increased significantly. In addition, the number of projects involving development of large-scale biomass projects has increased during the past few years.

Development issues

- 13 | What types of issues restrain the development of utility-scale renewable energy projects?

As described in question 10, the shortage of capacity of utilities' transmission lines is one of the major issues that restricts the development of utility-scale renewable energy projects, and the Japanese government is continuing its efforts to increase accessibility to the grid.

In addition, for renewable energy projects of a certain scale, an environmental impact assessment is required before development of the project. Regarding wind projects, for example, an environmental impact assessment is required for projects with an output of 10MW or more. It usually takes five years to complete the process and a large upfront cost is necessary before development. Uncertainty resulting from a time-consuming environmental impact assessment is one of the major issues that restricts the development of renewable energy projects.

HYDROPOWER

Primary types of project

- 14 | Describe the primary types of hydropower projects that are prevalent.

Historically, hydropower generation projects with large-scale dams have been an important source of energy and play a significant role in the renewable energy sector. These dams are developed and owned by vertically integrated utilities. Recently, however, small and medium-sized hydropower projects have also been gaining attention with the support of the FIT programme. Hydropower projects with output capacity less than 30MW are eligible for mandatory power purchase arrangements under the FIT programme.

Legal considerations

- 15 | What legal considerations are relevant for hydroelectric generation in your jurisdiction?

Although small and medium-sized hydropower generation projects are supported by the FIT programme, other types of hydroelectric technologies, such as electricity generation by wave power and tidal power, are not. To expand the field of hydroelectric power generation to wave power and tidal power, financial support from a governmental programme would be beneficial.

DISTRIBUTED GENERATION

Prevalence

- 16 | Describe the prevalence of on-site, distributed generation projects.

There are several companies that provide on-site, distributed generation projects (on-site projects provider) for their customers such as the owners of public facilities, factories, plants, airports, railway stations, shopping malls and residential areas. There are currently many on-site distributed generation projects in operation.

As for larger scale projects, there are several substantive micro-grid experiments in local cities and remote islands.

Types

- 17 | Describe the primary types of distributed generation projects that are common in your jurisdiction.

According to the materials distributed by on-site projects providers, there are many solar power plants owned by on-site projects providers (or, to a lesser degree, the offtakers, such as owners of factories or large buildings). These solar power plants are operated by the on-site project providers.

In addition, there are several 'inside-the-fence' distributed generation projects that are used to support factories or plants that require stable and large amounts of electricity (typically, 20MW to 100MW or more). These projects are usually thermal power plants (including biomass power plants) jointly developed by the offtaker (ie, the owner of the factory or plant) and an independent developer.

Regulation

- 18 | Have any legislative or regulatory efforts been undertaken to promote the development of microgrids? What are the most significant legal obstacles to the development of microgrids?

We are not aware of any major legislative or regulatory efforts that have focused specifically on the promotion of microgrids. However, there are certain subsidies provided by the government (the Ministry of the Environment) to compensate for the cost of installing microgrid systems that connect public facilities.

Regarding the obstacles to the development of microgrids, unlike the often-discussed technical obstacles, there are no significant legal obstacles to the development of microgrids.

Other considerations

- 19 | What additional legal considerations are relevant for distributed generation?

With respect to rooftop solar projects as distributed generation projects, there are legal issues as to the method by which to perfect the lease of rooftops. Under the current Real Property Registration Act, a part of a building, such as a rooftop, cannot be registered. As a result, the lease

right (as well as the security interest created on the lease right) of a rooftop may not be perfected.

Regarding net-metering, since the owner of a renewable energy project has the right to require a transmission utility to purchase all available electricity at a fixed price (see question 4), the owner of a renewable energy distributed generation project can sell all surplus electric power to the transmission utility.

ENERGY STORAGE

Framework

20 | What storage technologies are used and what legal framework is generally applicable to them?

While most types of renewable power generation can enjoy offtaking arrangements under the FIT programme, energy storage projects cannot. We have yet to see a commercially feasible stand-alone energy storage project in Japan.

Having said that, recently, large-scale batteries have been used together with utility-scale solar power projects in Hokkaido, the northernmost main island of Japan, at the request of the transmission utility there. However, the batteries are used to mitigate the rapid fluctuation of output from solar modules, not to store electric power. In addition to these behind-the-meter batteries, the transmission utility in Hokkaido is planning to install in-front-of-the-meter batteries to mitigate the fluctuation of the power output from wind power projects. Such batteries are expected to increase the grid connection capacity of the transmission utility.

Development

21 | Are there any significant hurdles to the development of energy storage projects?

The most significant issue is the high cost of batteries. In addition, under the current FIT programme, electric power output from an energy store is not eligible for mandatory purchase arrangements even if the electric power is originally created from renewable energy sources such as solar and wind. Due to the lack of long-term stable revenue stream, it is hard for energy storage projects to secure non-recourse project financing.

FOREIGN INVESTMENT

Ownership restrictions

22 | May foreign investors invest in renewable energy projects? Are there restrictions on foreign ownership relevant to renewable energy projects?

Yes, foreign investors may invest in renewable energy projects. However, a foreign investor who intends to acquire shares or similar types of equity in a Japanese entity that is involved or will be involved in electricity business (ie, power generation from renewable energy source) is required to submit to the Minister of Finance a pre-filing for approval of such acquisition. A foreign investor may acquire shares or similar types of equity only after approval is given. Approval is typically given after a waiting period of 14 to 30 days. If an electricity business of a Japanese entity is not scheduled to start within six months of the acquisition of shares or similar types of equity by a foreign investor, the foreign investor may first acquire the shares or similar types of equity without making a pre-filing for approval with the Minister of Finance. In such cases, the foreign investor must make another filing to the Minister of Finance for approval during the six-month period prior to the commencement of the electricity business.

Equipment restrictions

23 | What restrictions are in place with respect to the import of foreign manufactured equipment?

There are no restrictions specifically focused on the import of foreign manufactured equipment. However, the import of foreign manufactured equipment is prohibited, if prohibited materials (such as certain chemicals or toxic materials) are used to manufacture the equipment.

PROJECTS

General government authorisation

24 | What government authorisations must investors or owners obtain prior to constructing or directly or indirectly transferring or acquiring a renewable energy project?

Physical construction of a renewable energy power plant requires various permissions and authorisations related to land use, land development and environmental protection, such as permission for the conversion of agricultural land, forest development permission, a satisfactory result from the environmental impact assessment and notification (the contents of which must be acceptable to the authority) of a large-scale development.

To be eligible for the FIT programme, it is also necessary to obtain a certificate from METI on the renewable energy project in question.

In transferring and acquiring a renewable energy project from one entity to another, the permissions and authorisations together with the METI certificate mentioned above need to be transferred effectively. For such transfers, procedures required by the relevant authorities must be taken, such as notification of the transfer to the authority. In the case that the acquirer is a foreign investor, the acquirer is required to obtain approval from the Minister of Finance as described in question 22.

Offtake arrangements

25 | What type of offtake arrangements are available and typically used for utility-scale renewables projects?

Without any restrictions on project scale, a significant number of renewable energy projects are supported by the FIT programme, under which fixed-price (ie, the price set by METI depending on the type of renewable energy source and the output capacity of the project) and long-term (ie, 10, 15 or 20 years depending on the type of renewable energy source) offtaking is required of a licensed transmission utility.

Although credit rating of transmission utilities differs from utility to utility, credit support for a transmission utility (as an offtaker) is not normally required. Without such support, developers, owners, sponsors and financiers of projects normally accept the offtaking arrangement. Even if a transmission utility becomes insolvent, as long as the electricity transmission business in the region continues to operate, the owner of the renewable energy project would be able to enter into a new power purchase agreement with the company that takes over the transmission business. Since the purchase price and term of the offtaking arrangement are legally fixed under the FIT programme, the terms of the offtaking arrangement (except the period that has already expired) should remain unchanged even if the transmission utility becomes insolvent.

Procurement of offtaker agreements

26 | How are long-term power purchase agreements procured by the offtakers in your jurisdiction? Are they the subject of feed-in tariffs, the subject of multi-project competitive tenders, or are they typically developed through the submission of unsolicited tenders?

Under the FIT programme, an owner of a renewable energy project with a certificate from METI has the right to request a transmission utility to enter into a fixed-price (ie, price set by METI depending on the type of renewable energy source and the output capacity of the project), long-term (ie, 10, 15 or 20 years depending on the type of renewable energy source) power purchase agreement. A transmission utility is required to accept such request unless there is a legitimate reason not to. Further, legitimate reasons are strictly limited by and defined under the Renewable Energy Act.

Generally, the purchase price under the FIT programme is set by METI annually. Since April 2017, the purchase price for solar power projects with 2MW or more output capacity will be set through a bidding process held by METI. The process includes a semi-annual, nationwide process where a developer may submit a bid for a FIT price (not greater than the maximum price set by METI) applicable to its own project. METI only grants FIT certificates to solar power projects that have secured a FIT price through the bidding process.

Operational authorisation

27 | What government authorisations are required to operate a renewable energy project and sell electricity from renewable energy projects?

An owner of an electricity generation project with a certain level of output capacity needs to notify METI of its electricity generation business. In addition, in order to sell electric power under the FIT programme, the project owner must obtain from METI a FIT certificate for their renewable energy project.

Decommissioning

28 | Are there legal requirements for the decommissioning of renewable energy projects? Must these requirements be funded by a sinking fund or through other credit enhancements during the operational phase of a renewable energy project?

Since April 2018, a project owner with a FIT certificate is obligated to hold a certain amount of funds in reserve to secure the costs to decommission its renewable energy facility. This was updated in July 2018 to require a project owner with a FIT certificate to also report a plan on reserving decommissioning costs and the status of the funds held in reserve. METI has commenced investigating measures to secure such reserved funds. METI is currently engaged in discussions on assigning the role of collecting funds for reserves from the sales revenue of each project to the Expense Sharing Coordinating Body, a special entity organised pursuant to the Renewable Energy Act. METI intends to introduce new regulations on this matter by March 2021.

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TRANSACTION STRUCTURES

Construction financing

29 | What are the primary structures for financing the construction of renewable energy projects in your jurisdiction?

For equity financing, the Tokumei Kumiai structure is frequently used in addition to normal equity investment in shares of a project company. Tokumei Kumiai is a Japanese silent partnership and has been regularly used in various types of asset financings such as aircraft financing and real estate financing. This arrangement is popular among renewable energy projects owing to its pay-through nature resulting in tax efficiency at the project company level.

For debt financing, non-recourse project financing is usually available for FIT-based renewable energy projects such as solar, wind and biomass projects.

Operational financing

30 | What are the primary structures for financing operating renewable energy projects in your jurisdiction?

See question 29. The financing structure is normally designed and put into place at the construction phase to accommodate the operational phase so that there would not be any substantial changes to the financing structure when the project enters the operational phase.

UPDATE & TRENDS**Market trends**

- 31 | Describe any market trends with respect to development, financing or operation in the renewables sector or other pertinent matters.

On 1 April 2019, the Act of Promoting Utilization of Sea Areas in Development of Power Generation Facilities using Maritime Renewable Energy Resources came into force. Under the new Act, METI and the Ministry of Land, Infrastructure, Transport and Tourism will designate specific zones for the promotion of offshore wind projects, and the developer who will construct and operate an offshore wind farm within the zone will be chosen via a public tender offer process. It is anticipated that the first promotional zone will be determined during fiscal year 2019, and the first public tender offer process will take place in 2020.

Legislative proposals

- 32 | Describe any notable pending or anticipated legislative proposals.

On 1 April 2019, METI introduced a new regulation on certain solar PV projects that obtained certificates under the FIT scheme before 31 March 2014 but have not reached operational status. If a solar PV project falls within the scope of the new regulation, the applicable FIT price will be reduced unless the project satisfies certain conditions by the newly introduced deadline, and the applicable FIT period will be shortened unless the project reaches operational status by the newly introduced deadline. Parties that intend to invest in a solar PV project under development need to check if the new regulation applies to the target project.

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