

Renewable Energy 2022

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Renewable Energy

2022

Consulting editor**John Dewar****Milbank LLP**

Lexology Getting The Deal Through is delighted to publish the fifth 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.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on Bulgaria, Denmark, Indonesia, Pakistan and Turkey.

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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 consulting editor, John Dewar of Milbank 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 Japan. 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. After 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?

The definition of renewable energy varies depending on the relevant statute.

Under the Act on Special Measures Concerning Procurement of Electricity from Renewable Energy Sources by Electricity Utilities (the Renewable Energy Act), which regulates 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 period (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.

Renewable Energy Certificates

The most widely distributed renewable energy-related certificates in Japan are Non-Fossil Certificates. Non-Fossil Certificates were originally introduced in 2017 for electricity retailers to comply with the legal obligation to procure a certain percentage of their electricity from non-fossil sources. Since then, the role of Non-Fossil Certificates has expanded, and all the environmental values in renewable electricity procured by retail electric utilities are to be represented in Non-Fossil Certificates. At present, tracking information is not included in Non-Fossil Certificates, but it will be added to Non-Fossil Certificates in the future.

There are two other types of renewable-energy-related certificates in Japan: J Credit and Green Power Certificates. 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. 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.

Stripping attributes

5 | Can environmental attributes be stripped and sold separately?

Non-Fossil Certificates are obtained by the electricity retailer separately from the renewable energy. However, the electricity retailer is not allowed to resell the acquired Non-Fossil Certificates. In addition, under the current system, only electricity retailers can purchase Non-Fossil Certificates, and electricity consumers cannot directly acquire Non-Fossil Certificates themselves. In response to the increasing demand from consumers who want to access the value of electricity as a renewable energy source, the government is considering the introduction of a system that would allow consumers to directly acquire Non-Fossil Certificates.

J-Credit and Green Power Certificates can be stripped and sold separately. A purchaser of J-Credit may resell them to third parties. With respect to Green Power Certificates, only the initial holder may sell it to a third party; however, the purchaser from the initial holder is not allowed to resell it.

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 a renewable portfolio standard (RPS) programme. Since 2012, however, the FIT programme has replaced the RPS programme and has been bolstering the development of renewable energy projects. The upcoming proposed amendment to the Renewable Energy Act further introduces the FIP programme from 1 April 2022, under which applicable projects will earn a premium in addition to the revenue generated by the sale of electricity in the wholesale electricity market. The FIP programme will be initially available to renewable energy power sources such as solar power and wind that are deemed competitive enough to survive in the market without financial support from the government. This transition from the FIT regime to the FIP regime is in line with the government's policy to make renewable energy the main source of power in Japan.

In addition, in furtherance of the Japanese government's policy goal of achieving carbon neutrality by 2050, in March 2021 METI established a ¥2 trillion Green Innovation Fund with the twin goals of (1) supporting companies engaged in fields consistent with the Japanese government's Green Growth Strategy that require long-term, continuous funding support measures focusing on R&D projects; and (2) establishing incentive frameworks to ensure that companies supported as described above are committed to the stated policy goals such as the cancellation of projects that are not sufficiently committed to such goals.

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.

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. 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 Japanese government intends to reduce its greenhouse gas emissions by 46 per cent by 2030 compared with 2013 levels, a significant increase from the previous commitment of 26 per cent. In order to achieve this ambitious goal, the government plans to reform regulations that have been a hindrance to the further deployment of renewable energy. One example of such deregulation is the relaxation of environmental impact assessment procedures for the development of wind farms. While an environmental impact assessment is required for wind projects with an output of 10MW or more under the current legislation, the government is considering raising the threshold to 50MW so that small wind farms can be exempted from the time-consuming and costly environment impact assessment.

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 the Japanese government's policy goal of achieving carbon neutrality by 2050. The Japanese government pledged to reduce its greenhouse gas emissions by 46 per cent by 2030 compared with 2013 levels, a significant increase from the previous commitment of 26 per cent. METI is reviewing its Strategic Energy Plan, which currently calls for increasing the share of renewable and nuclear power in the power generation sector to 44 per cent by 2030.

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 feed-in tariff (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 the 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?

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, because of the increased number of solar and wind power projects since the commencement of the FIT programme, there is less and less land that is suitable for solar and wind power 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 feed-in tariff (FIT) programme. Hydropower projects with output capacity less than 30MW are eligible for mandatory power purchase arrangements under the FIT programme.

- 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 on-site project providers. In addition, another type of generation project has been used more frequently in Japan – the third-party ownership (TPO) model, wherein the solar power facility is operated by a contractor under the power purchase agreement and not by the site owner. Under the TPO model, site owners are able to develop renewable power plants with no initial costs. A third party other than the developer will normally bear the construction costs and own the facility, and the developer will enter into a power purchase agreement with the site owner. Site owners will be able to purchase power generated by the facility at a reduced price.

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 costs incurred to install microgrid systems that connect public facilities.

With regard to 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.

With respect to 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, 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 feed-in tariff (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 of the main islands 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.

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 FIT programme, if the owner of a solar PV facility installs battery after its receipt of FIT certificate, the applicable FIT price will be reduced. Therefore, it is not practical to install storage batteries in solar PV facilities under the FIT programme even if the cost of batteries were to decrease.

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 pertaining to renewable energy. 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. Foreign manufactured equipment may also be subject to licensing or approval requirements by laws and regulations other than those pertaining to renewable energy upon importation into Japan.

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 feed-in tariff (FIT) programme, it is also necessary to obtain a certificate from the Ministry of Economy, Trade and Industry (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 of its acquisition of 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).

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 large-scale solar power projects (with 250kW or more output capacity, as of April 2021) 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?

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 and also report a plan on reserving decommissioning costs and the status of the funds held in reserve. This requirement has, however, had limited effect as project owners were free to decide the level and timing to reserve such decommissioning costs. In response to this situation, the government has proposed an amendment to the Renewable Energy Act that requires project owners to reserve funds externally by a third-party agency, with an exception for projects that satisfy certain stringent criteria to reserve the funds on its own. This requirement will initially apply to solar projects with an output capacity of more than 10kW, under which a portion of the proceeds from the sale of electricity will be withheld by the third-party agency on a monthly basis, starting 10 years before the end of the FIT procurement period (the long-term period during which a transmission utility must purchase from renewable energy project owners all available electric power at a fixed price).

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?

For equity financing, the *Tokumei Kumiai* structure is frequently used especially for solar PV projects, while there are also structures where an equity investment is made in shares of a project company. For debt financing, non-recourse project financing is usually available for feed-in tariff-based renewable energy projects such as solar, wind and biomass

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projects. 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 AND TRENDS

Recent developments

- 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 Act, the Ministry of Economy, Trade and Industry (METI) and the Ministry of Land, Infrastructure, Transport and Tourism (MLIT) 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. Thus far, four zones have been selected and gone through the public tender process under the Act: Goto (Nagasaki Prefecture), Choshi (Chiba Prefecture), Noshiro (Akita Prefecture), and Yurihonjo (Akita Prefecture). The results of the tender will be announced later in 2021. METI and MLIT have further selected 'promising' zones for offshore wind development: in Happo (Akita Prefecture), the sea of Japan coast of Aomori Prefecture (north and south), and Saikai (Nagasaki Prefecture). These promising areas are expected to progress to the public tender process.

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

METI intends to introduce a new market to trade the environmental value of renewable energy. The new market will be called the Renewable Value Trading Market, to be implemented on a trial basis from the second half of 2021. The Renewable Value Trading Market will allow retail electricity

retailers as well as electricity consumers to purchase Non-Fossil Certificates. Whereas the current Non-Fossil Certificate regime allows only electricity retailers to participate through an auction conducted by the Japan Electric Power Exchange, the Renewable Value Trading Market is intended to allow environmentally aware consumers direct access to the environmental value of renewable energy.

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