



Frequently Asked Questions About

Japan's Feed-in-Tariff System

Spring 2013

JAPAN'S FEED-IN-TARIFF SYSTEM – SPRING 2013

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1. What are the Key Steps in the Process of Getting FIT Approval of and entering into a PPA?

Step 1: Planning and Facility Approval:

To be eligible to receive Feed-in-Tariffs (“FITs”), power suppliers who wish to generate electricity by using certain renewable energy sources including solar energy (“Renewable Electricity”) must first obtain approval from the Minister of the Ministry of Economy, Trade and Industry (“METI”) for the facility (“Facility”), which they intend to construct to generate Renewable Electricity (“Facility Approval”).

Step 2: Grid Connection and Power Purchase Agreement:

To receive FITs, a supplier must enter into an agreement to secure a power grid connection (“GCA”) and a power purchase agreement (“PPA”) with an electric utility operator (“Utility”) before starting the operation of a Facility.

Before starting the negotiation for a GCA and a PPA, Utilities usually require suppliers to submit a written request for prior consultation during which the Utility will conduct technical checks on items such as the compatibility of equipment. Such prior consultation and the Facility Approval can be pursued simultaneously once the site location and the type of equipment are determined. A supplier must also submit a separate written request to enter into a GCA and a PPA with a Utility.

Step 3: Commencement of Operations:

The term period of purchase (“Procurement Period”) applicable to a specified supplier (“Specified Supplier”) granted a Facility Approval that receives FITs for Renewable Electricity it supplies to a Utility starts from the day when a Specified Supplier begins supplying electricity to a Utility in accordance with a PPA following the completion of a test run. During the Procurement Period, a Specified Supplier must report on construction costs and operating costs to METI every year.

2. What are the Prerequisites for Facility Approval?

The main prerequisites for Facility Approval are:

- (a) The site location, equipment, manufacturer and equipment specifications (such as model number) of the power plant have already been determined;
- (b) The proposed Facility is expected to be capable of generating and supplying Renewable Electricity for the Procurement Period in a stable and efficient manner;
- (c) The supplier has established a system to provide maintenance and repair services for the Facility in Japan on a full-time basis throughout the Procurement Period, and maintenance and repair work can start within three months from the occurrence of a technical problem at the Facility;
- (d) The Facility is composed of a structure that is capable of monitoring the amount of electricity the supplier provides to a Utility;

- (e) The equipment meets the standards specified in the ordinances (the "Ordinance") of the Renewable Energy Sourced Electricity by Electric Utilities (Act No. 108 of 2011) (the "RE Act"), which came into effect on July 1, 2012; and
- (f) Generation of Renewable Electricity takes place while a breakdown of the setup costs (including the costs for the land for the Facility, grid connection and maintenance services) and operation costs of the Facility are recorded. The supplier is required to provide such data to METI every year for the purpose of determining the purchase price ("Procurement Price") and the Procurement Period for the following year.

3. What is Required to make Application for Facility Approval and How Long does the Application Process Take?

While the prerequisites mentioned above are required to be determined or arranged beforehand, the completion of the construction of the Facility is not required prior to applying for Facility Approval. Also, an applicant for a Facility Approval can be a special purpose company ("SPC").

The turnaround time for a Facility Approval for a solar power plant is estimated to be one (1) month from the date of submission of the required documents.

After Facility Approval is granted, the Specified Supplier is required to obtain prior approval from METI for any substantial changes to a part of the Facility, and to file an amendment notification with METI for any minor changes to the Facility.

4. How are the Terms and Conditions of the Grid Connection Agreement and Power Purchase Agreement determined?

Grid Connection Agreement ("GCA):

Under the RE Act, Utilities may not refuse a supplier's request to enter into a GCA, except for limited cases set forth in the RE Act. Utilities and suppliers can, in principle, negotiate the terms and conditions of the GCA except for certain terms specified in the RE Act. Although market practice in Japan is developing, in general the power purchasers are the regional electric companies that operate the power grids (i.e. Utilities). Consequently, in most cases the GCA will be combined with the Power Purchase Agreement into a single agreement or two agreements negotiated and entered into concurrently.

Power Purchase Agreement ("PPA):

Similarly, Utilities and suppliers can, in principle, negotiate the terms and conditions of the PPA except for the term of the Procurement Period and the purchase price (the "Procurement Price") payable during such Procurement Period, which are determined by METI, and other terms designated by the RE Act. Under the RE Act, Utilities may not refuse a supplier's request to enter into a PPA for a period which does not exceed the applicable Procurement Period, except for limited cases (see below). The supplier does not need to enter into a PPA with the same Utility with which it executed a GCA as explained above.

5. Is There a Model Contract to Guide the Discussion between the Parties?

Model Contract:

On September 26, 2012, METI released a model contract to be used for GCAs and PPAs (the “Model Contract”). The Model Contract can be found here (only in Japanese): http://www.enecho.meti.go.jp/saiene/kaitori/dl/2012denki_keiyaku.doc

In its press release, METI described the Model Contract as complying with the RE Act and “other provisions defined in the related laws and regulations, while considering practical requirements and other procedures related to fundraising activities” of suppliers. In response to the introduction of FITs, each Utility prepared standard terms and conditions (*yakkan*) (“Utility Terms”) as part of the GCA and PPA which the Utility expected to be accepted by Suppliers without any amendments. According to METI, it released the Model Contract because Utility Terms (i) vary in terms of contents, some of which included terms that were not always consistent with the RE Act; and (ii) were not drafted for Suppliers to be able to obtain financing from banks.

The Model Contract was drafted for use under the following circumstances:

- The Supplier sells Renewable Electricity to the Utility with which the Supplier acquires grid connection (in other words, the Supplier enters into the GCA and PPA with a single Utility);
- The subject project has a capacity to generate 500kW or more Renewable Electricity;
- The Supplier and Utility enter into the contract before starting the construction of approved facilities for power generation; and
- The Supplier intends to obtain finance from banks for the project.

As METI notes, the Model Contract is an example of a GCA and PPA and can be modified as appropriate to reflect the nature of energy sources, sizes of facilities for power generation and other circumstances of a particular project as long as the contract is in compliance with the RE Act and other applicable regulations.

The following are some of the key provisions of the Model Contract:

Contract Term (Article 1.2):

The contract term is to be a specified period (e.g., 20 years) that does not exceed the Procurement Period and does not allow the Utilities an option to terminate the contract after one year.

Compensation for Supply Suspension (Article 3.2):

Under the RE Act, Utilities are allowed to require a Supplier to suspend its Renewable Electricity supply without any compensation under certain limited circumstances such as, for example, a force majeure event, an accident, or a periodic check. However, if the total suspension period exceeds the maximum period (i.e., 30 days) permitted by the RE Act, the Utilities are required to compensate the Suppliers for the suspension. The Model Contract provides more details, in particular, the method of calculating such compensation.

Assignment of Rights and Obligations (Article 7.2):

Under the Model Contract, the Supplier is, upon obtaining prior consent from the Utility, allowed to assign the Supplier's rights and obligations under the GCA and PPA to lenders for financing purposes. This provision was incorporated specifically to allow Suppliers to satisfy the conventional condition imposed by banks and other lenders providing project financing that they receive an assignment of the rights and/or obligations under the GCA and PPA. However, the prior consent requirement is criticized and the removal of such requirement has been negotiated with Utilities.

6. How are the Procurement Price and Procurement Period Set?

The Procurement Price and Procurement Period are determined by METI in respect of each fiscal year in Japan (i.e., April 1 to March 31). The Procurement Price for solar power generated Renewable Electricity for the fiscal year 2012 was determined to be JPY 40 per kW for a Facility with the output capacity of 10kW or more. The Procurement Period for solar power generated Renewable Electricity for the fiscal year 2012 was determined to be 20 years for a Facility with the output capacity of 10kW or more.

The Procurement Price and Procurement Period for the fiscal year 2013 (i.e., April 1, 2013 to March 31, 2014) and thereafter will be determined by METI taking into account the profitability of Specified Suppliers and broader economic circumstances. The Procurement Price for solar power generated Renewable Electricity for the fiscal year 2013 was determined to be JPY 37.8 (including tax, 36 without tax) per kW for a Facility with the output capacity of 10kW or more. The Procurement Period for solar power generated Renewable Electricity for the fiscal year 2012 was determined to be 20 years for a Facility with the output capacity of 10kW or more.

7. Is there a risk that the utility may refuse to enter into a PPA although METI approved a Facility application?

Yes, in limited cases. Utilities may refuse to enter into a GCA and a PPA with a supplier only in limited cases where, for example:

- (a) The requesting supplier is not a Specified Supplier;
- (b) The Specified Supplier does not bear the costs for the grid connection specified in the Ordinance;
- (c) The proposed GCA will have an adverse effect for the Utility to ensure a stable supply of electricity;
- (d) The proposed GCA or PPA requires the Utility to pay compensation for damages incurred by the Specified Supplier even if such damages are not attributable to the Utility;
- (e) The Specified Supplier does not agree to cooperate with a potential suspension of electricity output by the Utility under the RE Act (please see "8. Risk of Suspension" below for more details); or
- (f) The proposed GCA's or PPA's exclusive court jurisdiction is not Japanese courts, governing law is not Japanese law, or original written language is not Japanese.

8. Is there a Risk of Suspension?

Yes, the RE Act entitles a Utility to require Specified Suppliers to suspend its electricity supply without any compensation under, for example, the following limited circumstances:

- (a) Where the Utility has taken certain actions to reduce the electricity supplied to it, and it is still expected that the electricity supply will exceed its demand, then the Utility is entitled to suspend electricity supply from a Specified Supplier whose Facility has a capacity of 500kW or more provided that the aggregate period the Utility made the Specified Supplier to suspend electricity supply does not exceed 30 days per year; or
- (b) A “compelling reason” as stipulated in the Ordinance (for example, a force majeure event, an accident, or a periodic check).

9. How are Rights-of-Way for Generation-Tie Lines (“Gen-Tie Lines”) procured? Are there rights of away under the RE Act?

Rights-of-way for Gen-Tie Lines are not provided by law and are not provided even though METI approves a facility. Rights-of-way will need to be negotiated separately with individual landowners. In other words, there are no statutory easements at present and parties are left to procure contractual easements on their own.

10. Is there a limit on the length of the Term of Land Lease?

Yes, a lease of undeveloped land, other than a lease for the purpose of having a building, may not be for a term exceeding 20 years. However, the parties can agree to extensions subject to mutual agreement. Another alternative which is being used in the market is for parties to enter into a short term lease (e.g., 3 years) to run while a project is being developed. The short term lease will be followed by a longer term lease (e.g., 20 years) to run current with the Procurement Period under the relevant PPA.

11. Can a Project obtain a Purchase “Option” for a Project Site?

Yes. But generally landowners in Japan will not grant a purchase “option” as seen in Western countries. Rather, market practice in Japan is for the parties to enter into a Conditional Purchase and Sale Agreement. If all specified conditions are satisfied the parties will be required to perform.

12. How are the Purchasers rights under a Conditional Purchase and Sale Agreement perfected? What formalities need to be followed?

Perfection:

A Conditional Purchase and Sale Agreement should be registered with the office of the Legal Affairs Bureau having jurisdiction over the land. There are two (2) types of registration: Full and Provisional. In practice, only Provisional Registration is used for such conditional sale agreements and landowners will not agree to “full” registration as long as the sale is subject to condition.

The costs of Provisional Registration are but a fraction of the costs of Full Registration. Provisional Registration will serve as legal notice to all third parties of the rights of the purchaser. Practically speaking the landowner will not be able to sell the property without the consent of the purchaser as no third party will be willing to buy the property subject to the Provisional Registration and removal of the registration will require the consent of the purchaser. However, it should be noted that Provisional Registration does not provide a perfected right that could be foreclosed upon by the purchaser. To obtain such a right the purchaser would need to convert the Provisional Registration into a Full Registration. Such conversion, however, will require the consent of the landowner/seller.

Formalities:

The Conditional Purchase and Sale Agreement will be subject to Japanese stamp tax. Other formalities such as notarization, are not required by law but may be required by the counterparty as a matter of contract terms.

13. Is there a Risk of Non-Performance by the Seller?

As with any contract there is always a risk that the counterparty may not perform its obligations. In the event that the seller/landowner refuses to conclude the sale despite all conditions having been satisfied, the remedy of the buyer would be to sue for breach of contract in Japanese court. In theory, the remedy of specific performance is available to the buyer but foreign buyers should take note that Japanese courts are very reluctant to order specific performance and a damage remedy is more likely. Moreover, damages are generally limited in Japan to direct damages only and damage calculations are made very conservatively. Punitive damages are not available in Japan.

14. What Permits (land, environmental, building, etc.) are Required to Build and Operate a Solar Project?

The permits required will vary depending on the location and circumstances affecting the project site. For example, permit requirements may vary by prefecture or local government or if the site is near to a protected land area. Below is an example list of what may be required under major regulations without taking into account local government regulations. The below list is not an exhaustive list and there may be other applicable regulations. The applicable regulations are usually definitively identified through the property due diligence and discussion with METI and local government.

Legislation	Acts requiring licenses, approvals or notification
Electricity Business Act (電気事業法)	Technical and regulatory requirements for construction of a power generating facility.
Soil Contamination Countermeasures Act (土壌汚染対策法)	A 14 day prior notification to the governor of relevant prefecture may be required for construction that will change the character of land (e.g., drilling land, filling soil on land) with an area of more than 3,000 square meters.
Factory Location Act (工場立地法)	A 90 day prior notification to the mayor of the relevant city or the governor of relevant prefecture may be required for constructing a power plant on land of more than 9,000 square meters.
Forestry Act (森林法)	Permission by the governor of the relevant prefecture may be required to construct a power plant within designated forestry area.

Act on Regulation of Residential Land Development (宅地造成等規制法)	Permission by the governor of the relevant prefecture may be required for changing character of land (e.g., drilling land, filling soil on land) within the designated area.
City Planning Act (都市計画法)	Development permission by the governor of the relevant prefecture or mayor of the relevant city may be required to construct a power plant within the designated area.
Building Standards Act (建築基準法)	A power generating facility may fall under a building structure, which requires a confirmation, depending on the size and structure.
Environmental Impact Assessment Act (環境影響評価法)	An assessment (which could take one to two years) may be required.

15. If an SPC is used to hold the land on which a Facility is to be built will the SPC be required to have a license?

If an SPC will be used to hold the land on which the project is situated and financial investors will invest in the SPC or into the SPC holding structure then in principal the SPC will be required to have a license under the Real Estate Specified Joint Enterprise Act. Obtaining such a license is legally possible although it could be time consuming and costly. For example, holders of such licenses are required to satisfy certain insurance and capitalization requirements for consumer protection purposes. In practice, it will not be practical for project sponsors to meet these requirements. However, the market in this area is developing and ways to avoid the SPC being subject to this licensing requirement are being employed by market participants. In general careful structuring of the investment can avoid this requirement being imposed.