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Michael Graffagna

Dale Caldwell

Nicholas Spiliotes

Frederick Jenney

Joel Friley

Jana Mansour

Christian Petersen

Outline of Japan's Feed-In Tariff Law for Renewable Electric Energy

By Michael C. Graffagna and Yoshinobu Mizutani

To encourage new investment in renewable electricity generation facilities and promote the use of renewable electric energy, in late August the Japanese Diet passed The Act on Special Measures concerning the Procurement of Renewable Electric Energy by Operators of Electric Utilities (the “**Act**”). Under the Act, Japanese electric utility operators are obligated to purchase solar, wind, hydro, geothermal and biomass generated electricity for contractual terms and at prices to be fixed by the Minister of Economy, Trade and Industry (“**METI**”).

This Client Alert summarizes the key features of the Act.

1. ELECTRICITY TO BE PURCHASED; EFFECTIVENESS; IMPLEMENTING REGULATIONS

The Act applies to solar, wind, hydro, geothermal and biomass generated electricity (“**Renewable Electricity**”)^[1] – the renewable energy sources currently in daily use. The Act only addresses renewable electricity generation and not other renewable energies – for instance biofuels or biogas. The Act does provide for the possibility of other renewable energy sources being added in the future through government regulation.

The Act takes effect from July 1, 2012, meaning that Renewable Electricity that is available on or after that date and that otherwise meets the statutory and regulatory requirements for purchase is the subject of the Act. METI is to adopt implementing regulations (the “**Implementing Regulations**”) on or prior to the effective date of the Act. It is expected that the first draft of the Implementing Regulations will be available early in 2012 and that a period and mechanism for public comment on the Implementing Regulations will be provided.

In order for a supplier of Renewable Electricity to benefit from the Act, the supplier will need to obtain the approval of METI by complying with criteria for the power generating facilities and methods for generating Renewable Electricity that are to be set forth in the Implementing Regulations.

2. PURCHASE OBLIGATION

Under the Act, electric utility operators are required to enter into power purchase agreements with suppliers of Renewable Electricity that have obtained the above approval of METI (“**Specified Suppliers**”) and to interconnect their electric

^[1] Although not defined by the Act, the term “renewable energy” is the generic term given to non-fossil fuel energy sources that can be used perpetually (see “Preparations for the Introduction of the Feed-in Tariff Scheme for Renewable Energy” dated July 23, 2011 by the Project Team on Japan's Feed-in Tariff Scheme of the Ministry of Economy, Trade and Industry.)

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transmission and other electricity facilities with the power generation facilities of the Specified Suppliers. On an annual basis, METI is to set the term of the power purchase agreements required to be executed by the electric utility operators during the applicable annual period as well as the electricity price that is to be paid during such term and to report the same to the Diet. The Implementing Regulations are expected to clarify the scope of the power purchase agreements subject to the price and term determined by METI for a particular year.

The price and term for power purchase agreements is to vary by the type, installation mode, scale and other factors of the relevant Renewable Electricity source and is to be determined by METI after listening to the opinions of other relevant governmental ministries and based on the opinion of the “Procurement Price Calculation Committee” (consisting of five members appointed by METI with the approval of the Diet) to be newly established as a neutral third party committee. In determining the price and term of the power purchase agreements, the Act requires METI to respect the opinion of the Procurement Price Calculation Committee.

The purchase price is to be determined taking into consideration (i) the costs recognized as being generally required to be incurred by the Specified Suppliers where the supply of Renewable Electricity is carried out efficiently, (ii) the estimated amount of Renewable Electricity to be supplied, (iii) the overall Renewable Electricity supply situation in Japan [although not clear from the Act or the Diet deliberations, it is possible that this factor could include consideration of balancing and firming needs of the electric utility operators], and (iv) the profit that Specified Suppliers should make and other factors. For the purpose of intensively expanding renewable electricity generation, the Act requires METI to “give particular consideration” to the profit that Specified Suppliers should make when setting the purchase price for power purchase agreements during the period of three years from the Act’s effective date (July 1, 2012 to June 30, 2015). The language implies that such power purchase agreements will be entitled to a higher purchase price than later ones – thus incentivizing suppliers who choose to be first movers.

The term of the power purchase agreements is to be determined taking into consideration the standard period expected between the start of supply of Renewable Electricity from the applicable generation facilities to the renewal of a material part of those facilities. Although not set forth in the Act itself, from the content of the Diet deliberations, it seems that the periods being referred to in the Act may be linked to the depreciation period of the generation facilities, with periods of 10 to 20 years having been mentioned.

The Act sets forth exceptions to the obligation of the operators of electric utilities to purchase the full amount of Renewable Electricity that is generated by the Specified Suppliers. Operators are excused from their obligation to enter into power purchase agreements and make related interconnections if there is “a likelihood of unjust harm to the benefit of operators of electric utilities,” “a likelihood of the occurrence of damage to securing the smooth supply of electricity” or “a just reason as set forth in the [Implementing Regulations].”

3. RECOVERY OF PURCHASE COSTS

The Act allows costs incurred by the operators of electric utilities in the purchase of Renewable Electricity to be recovered through charges to end users in proportion to the amount of energy used. Specifically, this means that operators of electric utilities can recover by invoicing users for a surcharge in addition to the amount usually charged for the supply of electricity. The basis for calculating the surcharge amount will be determined by METI on an annual basis.

The Act does provide that the operators of electric utilities must make efforts to streamline their business operations, lower the costs of their business operations and take other necessary measures to reduce the amount of the surcharge.

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4. EXCEPTIONS

There are a number of important exceptions from the basic framework of the Act:

- **Residential Solar Power** – The existing system, which provides for the purchase of surplus power generated rather than the full amount generated, will be maintained for solar power generated at residences, etc.
- **Price Relief for Industrial Users** – A reduction in the surcharge of 80% or more is to be provided to business facilities whose annual electricity usage amount exceeds an amount to be set forth in the Implementing Regulations, upon application by a business operator whose ratio of electricity usage (in kWh) to sales volume (per 1000 yen) (i) exceeds 8 times the average ratio in the manufacturing industry (if a manufacturer) or (ii) exceeds the average ratio in the non-manufacturing industry (if a non-manufacturer) by a factor to be determined in the Implementing Regulations.
- **Price Relief for Earthquake Victims** – Electricity users of offices, residences and other facilities and equipment that were severely damaged in the Great East Japan Earthquake and who meet additional requirements (if any) provided for in the applicable government ordinances will not be invoiced the surcharge during the nine month period from July 1, 2012 to March 31, 2013.

5. REVIEW PROVISIONS

The Act requires that necessary measures be taken (i) if there are any changes to the government's Basic Energy Plan set forth in the Basic Act on Energy Policy and (ii) at least every three years, considering factors such as the Renewable Electricity supply situation and projections for such supply, the amount of electricity charges to end users and projections for such charges, the impact of such charges to individuals, the burden of surcharges on the economic activities of high volume and other electricity users and the changes in domestic and international social and economic conditions, and that a fundamental review of the Act be conducted no later than March 31, 2021.

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The Act leaves open many of the items critical to its ultimate success in increasing the use of renewable electricity in Japan. The criteria for approval of Specified Suppliers, the exceptions releasing electric utility operators from their obligations to purchase all Renewable Electricity generated, the requirements for interconnection and the specifics of the price relief for certain industrial users, among others, are all to be determined in the Implementing Regulations. The all-important contractual term and pricing for the power purchase agreements are to be determined by METI based on the input of the Procurement Price Calculation Committee. Consequently, it will be critical for interested parties to pay careful attention to the content of the proposed Implementing Regulations and the mechanism for the actual determination of the contractual terms and pricing.

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Contact:

Michael C. Graffagna

Tokyo

+81 3 3214 6522

mgraffagna@mofo.com

Yoshinobu Mizutani

Tokyo

+81 3 3214 6522

ymizutani@mofo.com

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