

Client Alert

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Japan's Power Market Reform Movement and Opportunities for Foreign Investors

The Act for Partial Revision of the Electricity Business Act (the "**Amended Act**") was enacted on 13 November 2013. The revision prepares for the first stage of the power market reform, which is to establish the Organization for Cross-regional Coordination of Transmission Operators ("**OCCTO**") by 2015. In connection to the reform, much attention has been focused on TEPCO's post-Fukushima activities, including its public bidding process to replace aged thermal power plants. This Client Alert provides a brief update on these issues.

1. Partial Revision of the Electricity Business Act

The Japanese Government expects to fully liberalize the electricity market by 2020. The three major objectives of the reform are to:

- secure a stable supply of electricity;
- suppress electricity rates; and
- provide greater choice to consumers and increase competition amongst business operators.

The Bill for the Amended Act passed on 15 October 2013. The Amended Act was enacted on 13 November 2013 and sets out that it will come into force within two years and six months.

The latest Amended Act is one of the several amendments to be made to accommodate the three stages of the power market reform. This time, the main aim for the amendment was to establish OCCTO, which will monitor the electricity market reform and the liberalized market thereafter. Further amendments are under review for the liberalization of the electricity retail market in 2016 and unbundling of the transmission and distribution sectors by 2020.

2. The OCCTO's Functions

Following the enactment of the Amended Act, the government established working groups in preparation to set up OCCTO, which will be an independent agency led by a chairman approved by the Ministry of Economy, Trade and Industry ("**METI**"). The main functions of the OCCTO will be to:

- monitor power generation capacity (e.g. increase generation in case of an emergency);
- oversee reinforcement of transmission systems (e.g. increase DC transmissions, reinforce pipelines between 50/60 Hz areas);

For further information please contact

Anne Hung

Partner

+81 3 6271 9443

anne.hung@bakermckenzie.com

Ean Mac Pherson

Partner

+81 3 6271 9468

ean.macpherson@bakermckenzie.com

Toshio Sasaki

Of Counsel

+81 3 6271 9739

toshio.sasaki@bakermckenzie.com

Baker & McKenzie

(Gaikokuho Joint Enterprise)

Ark Hills Sengokuyama

Mori Tower 28F

1-9-10, Roppongi, Minato-ku

Tokyo 106-0032, Japan

Tel + 81 3 6271 9900

Fax + 81 3 5549 7720

www.bakermckenzie.co.jp

- become a one-stop reception desk to coordinate network access (e.g. grid connection for renewable projects);
- encourage companies to enter and trade on the Japan Electric Power Exchange (JEPX); and
- monitor market competition.

The government plans to establish the OCCTO by 2015.

3. TEPCO's Bidding Process

On 18 September 2012, METI issued the "Guidelines for Bidding on Thermal Power Generation Facilities" requiring utilities to hold public bidding processes to construct, expand or replace thermal generation facilities with a capacity of 1 MW or more (the "**Tender Guidelines**".)

In February 2013, TEPCO called its first round bid. On 30 July 2013, it was announced that Chubu Electric will build a 600 MW coal-fired power plant in Hitachinaka (380 MW to be supplied to TEPCO), and J-Power and Nippon Steel will jointly build a 600 MW coal-fired power plant in Kashima (300 MW to be supplied to TEPCO).

TEPCO aimed to procure 2,600 MW of capacity in this first round but the total only reached 680 MW. The second round was expected to be held within 2013 for 10,000 MW plus the shortfall amount. A news article in November 2013 stated that TEPCO would be holding the second round in December 2013 with the price cap removed. However, TEPCO immediately announced that the process for the second round was still under review.

Additionally, following the release of radioactive water into the sea, the government has become heavily involved in TEPCO's management and is in the process of splitting up the decommissioning sector. TEPCO has announced on 20 December 2013 that the "Decommissioning Company" will be set up by April 2014. This would segregate the debts from the nuclear pollution, leaving a financially healthier TEPCO to return to business.

A new Comprehensive Special Business Plan for TEPCO was released on 15 January 2014, which states that TEPCO's Fuel & Power Company will set up a special-purpose company to handle thermal power plant replacements. According to the plan, there will be another bid within FY2013 for the 2,600 MW replacement. The invitations to a separate IPP bid for part of the 10,000 MW replacement will be completed within FY2014. Invitations to bid for any outstanding replacements will then be completed by 2016, and the replacements completed by 2020. TEPCO has set aside a budget of 450 billion Japanese Yen for ten years to invest in new gas turbines and to enter into partnership with other companies to replace thermal power plants.

4. Other Reforms on the Way

METI has also set up a working group to consider a gas market reform. This is still in the early stages and it is unclear whether the timing will be the same as the power market reform. However, the underlying concept appears to be similar in that the gas market reform also aims to liberalize the retail market and improve gas supply pipelines.

Further Updates

We will continue to monitor developments on the power and gas market reforms closely and provide further updates.