

Client Alert

October 2013

Japanese Solar Projects – a new deadline to develop approved projects?

A key question asked by many foreign investors seeking to acquire interests in Japanese solar projects is whether there is any deadline for project developers to construct and begin operation of existing approved projects.

Solar projects in Japan are governed by the "Special Measures Law Concerning the Procurement by Electric Power Companies of Renewable Energy Electricity" enacted on 26 August 2011 (the "Renewable Energy Law").

As described in our [May 2013 Client Alert](#), projects that obtained the required approvals under the Renewable Energy Law by 31 March 2013 are eligible to enter into a 20-year power purchase agreement with their applicable regional utility at a fixed purchase price for the entire 20-year period of 42 yen/kWh (tax inclusive).

To apply for the above approvals, project developers were required to specify the intended commercial operation start date of their renewable energy facility. However, the Renewable Energy Law and implementing regulations do not clearly specify what the consequences will be for project developers that do not commence operations within such specified start up date.

On 20 August 2013, the Japanese Ministry of Economy, Trade and Industry ("METI") released figures showing that 18,681 GW of commercial scale solar projects received approvals under the first round feed-in tariff programme which ended on 31 March 2013. However, of all approved projects, only 961 MW had commenced operations by May 2013. METI further announced on 4 October 2013 that this has increased to 1,416 MW by June 2013. A significant number of approved projects therefore do not appear to have commenced construction or operation yet.

At the same time as releasing the above announcement, METI therefore also announced that it would begin looking into projects that had not yet commenced construction. However, METI did not specify what form its investigation would take or what measures METI might implement against projects that were experiencing construction delays.

The above situation has now become clearer. In September 2013, both METI and the Hokkaido Electric Power Co.,Inc. ("HEPCO") began their investigations into projects that had not yet commenced construction.

Details of the investigations commenced by METI and HEPCO (including the information requested from each approval holder for each approved facility) and our comments on the implications of such investigations for investors looking to acquire interests in existing approved solar projects are set out below.

1. The METI Questionnaire

In mid-September 2013, METI issued a detailed questionnaire to holders of renewable energy project approvals under the Renewable Energy Law. The questionnaire was sent to all holders of all solar projects approved prior to 31 March 2013 which have a capacity over 400 kW. The questionnaire is required to be completed and returned to METI within one month (i.e. by mid-October 2013).

The information requested from each approval holder in the questionnaire is detailed. In particular, the approval holder is required to report back to METI with information on whether the approval holder:

- (a) has acquired rights to the project land and commenced electricity supply under a power purchase agreement with its offtaking utility; or
- (b) has abandoned construction of the approved facility (and if so the reason why);

but if neither (a) nor (b) above apply, the approval holder must then specify if it:

- (c) intends to commence operations in the future (and if so, the scheduled or actual construction and operation start dates);
- (d) has entered into a purchase agreement or order with a module supplier for the project solar modules (and provide a copy of such agreement or confirmed order); or
- (e) confirms that it will carry out the project at the project site and if so, provide details of rights it has obtained to such project site (e.g. land ownership, surface rights or lease rights) and a copy of the documents showing such rights.

If any of (c) to (e) above do not apply,

- (f) then the approval holder must specify:
 - (i) if (d) above does not apply, the intended date on which it will place an order for modules; and/or
 - (ii) if (e) above does not apply, the intended date on which the approval holder confirms it will carry out the project.

In addition, the approval holder must provide details on whether the approval holder:

- (1) is in the process of negotiating grid connection with the applicable utility (and provide copies of documents related to that process);
- (2) is awaiting government approvals to begin project construction (such as conversion of agricultural land to allow it to be used for the project purposes);
- (3) has begun financing discussions with lenders for the project (and if so, which lending institutions it has contacted and the specific names of the persons contacted);

- (4) has any other reasons for not yet commencing project operations; or
- (g) if (f) above does not apply, the approval holder must supply its intended schedule to construct and operate the project.

METI states in its letter that any false reports or failure to respond within the one month deadline may result in a fine of up to JPY 300,000. Depending on the response received, METI may also send its staff to the project site or office for an on-site inspection.

The METI letter does not precisely specify what measures (if any) METI may impose in relation to an approved project if it is not satisfied with its progress and the Renewable Energy Law is also silent on the precise consequences of delays in project construction and operation.

METI does say however, that for projects that have construction delays, METI will “evaluate” whether to maintain the 42 yen/kWh price for such projects.

There is therefore some uncertainty on what the final result of the above METI questionnaire process may be for such projects, including whether some projects may face a risk of losing their valuable 42 yen/kWh price approval.

2. HEPCO’s Letter

At the same time that METI issued the above questionnaire, HEPCO also issued a similar letter to holders of approvals for projects located in Hokkaido.

The HEPCO letter required the following information be submitted to HEPCO in relation to the approved project:

- Business plan summary;
- Signed land purchase contract or lease agreement;
- Evidence of financial support for the project; and
- Project construction timetable.

We understand that in most cases the above information was required to be submitted to HEPCO by the end of September 2013.

HEPCO has informed approval holders that the above information will be used by HEPCO to decide which projects it will continue to accept for grid connection.

3. Consequences

For approval holders with first round projects in Hokkaido, the above HEPCO investigation process appears to be key to determine whether such projects will be accepted by HEPCO for grid connection.

The consequences of the METI questionnaire are not as clear.

It has been reported that METI is concerned that holders of approvals granted prior to 31 March 2013 may be “sitting” on such approvals and waiting to develop their projects after module prices decrease. This would frustrate the purpose of the feed-in tariff programme under the Renewable Energy Law which intentionally sets a high feed-in tariff for the first feed-in tariff year to spur quick investment in solar projects and to reflect actual project costs (including module prices) during that initial year.

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In practice, it appears many existing approved projects are experiencing delays in commencing construction due to various issues including the need to convert land use categories, and difficulties obtaining financing, suitable EPC contract arrangements and/or an appropriate joint venture partner.

METI's questionnaire gives approval holders the chance to provide information on whether issues such as the above have affected the progress of the project. However, the importance METI will place on each of the above factors in evaluating whether such projects can keep their approved 42 yen/kWh price is not yet clear.

Nevertheless, the fact that METI and HEPCO have now begun the above investigations appears to indicate there may be a certain risk for approval holders that cannot demonstrate that they are making steady progress towards starting project construction and operation.

For investors seeking to acquire interests in existing approved projects the above measures are likely to have the following key consequences:

- existing approval holders may need to speed up their process to find suitable investors or joint venture partners to develop their projects;
- existing approval holders will need to demonstrate to METI that they are taking concrete steps to develop their projects;
- careful monitoring of existing approved projects will be necessary to determine their actual progress and the risk of possible adverse action by METI (including close examination of the response provided by such developers to the above METI questionnaire);
- the proper structure for acquisition of such project interests may need to be carefully considered (including whether to structure such acquisitions with staged purchase price payments or other conditions tied to actual project development); and
- there will be a need to bring such projects into construction and operation more speedily to avoid the risk of adverse action by METI (including the possible loss of the first round 42 yen/kWh tariff held by such project).

At the very least, the METI and HEPCO investigations appear to increase the pressure on existing approval holders to demonstrate that they are taking concrete steps to reach the project construction stage.

Further Updates

We will continue to monitor the implementation of the new Renewable Energy Law and to provide further updates.