

## Client Alert

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## Japan's retail electricity market: frequently asked questions from foreign entrants

In April 2016, the Japanese electricity market was fully opened to retail-level competition. This brought significant change to a power market — one of the largest in the world — which had previously been dominated by 10 power utilities, each of which held a regional monopoly over retail electricity sales. Since the market opening, over 400 new Japanese companies have registered to become electricity retailers, introducing significant new competition into the market.

With the reform program gaining pace, a number of foreign electricity retailers have also now obtained licenses to commence retail electricity sales in the Japanese market. As such companies introduce their home market experiences and practices into Japan, this is also bringing additional change in the Japanese retail sector. Given the size of the Japanese electricity market and the relatively high electricity prices in Japan, further interest in the market from foreign electricity retailers is expected.

In this alert, we look at some of the common questions asked by foreign companies wishing to enter the Japanese retail electricity market and outline a number of key issues for such companies.

### Can foreign companies become electricity retailers in Japan?

Yes. It is possible for foreign companies to obtain the required licenses to engage in the retail electricity business in Japan. A number of foreign companies have done this and have already commenced operations.

Foreign companies wishing to obtain electricity retailer licenses in Japan are required to go through the same application procedures — described below in greater detail — as Japanese companies. Provided that such foreign companies can demonstrate that they have sufficient management and financial resources to comply with the retail license requirements, the Japanese Ministry of Economy, Trade and Industry ("**METI**") will generally treat their applications in a similar manner to applications from Japanese companies.

Certain special rules do, however, apply to the transfer of funds into Japan by foreign companies in specific business areas. Under these rules, foreign companies operating in the Japanese retail electricity sector must file notices with the Bank of Japan for certain categories of capital remittances into Japan. However, this is primarily a notification process and not a bar to actual investment. We are not aware of the Bank of Japan rejecting any investments by foreign companies in the retail electricity sector since the April 2016 liberalization.

### Who are the licensing authorities and what are the key laws?

The Japanese electricity market reform program is administered by METI. Within METI, applications for electricity retailer licenses must be made to the Electricity and Gas Market Surveillance Commission (*Denki gasu torihiki kanshi tou iinkai*), which is responsible for granting electricity retailer licenses and supervising electricity retailers to ensure their compliance with the law.

The key legislation within Japan that governs the retail electricity sector is the Electricity Business Act (*Denki Jigyō Hō*) (Act No. 170 of July 11, 1964).



The Electricity Business Act as now amended sets out the requirements to apply for and maintain electricity retailer licenses. For electricity retailers, the key focus areas of the Electricity Business Act include ensuring:

- that new retailers are able to provide stable electricity supplies to their customers; and
- that appropriate levels of consumer protection are provided to customers.

In addition to the Electricity Business Act itself, METI has also released guidelines for electricity retailers which further protect the rights of retail customers. These set out various rules which all electricity retailers are recommended to follow, including matters relating to (i) disclosure of information to customers, (ii) sales activities, (iii) electricity supply contract terms and conditions, (iv) handling of customer complaints and (v) procedures to terminate electricity supply contracts.

### **What is the procedure to obtain an electricity retailer license?**

The Electricity Business Act requires companies wishing to engage in retail electricity sales activities to first obtain a retailer license from METI. Applications for electricity retailer licenses must be made using the prescribed forms and must include various required details, including information to demonstrate that the applicant has the ability to:

- secure sufficient power supply capacity to meet demand from potential customers;
- viably conduct the electricity retail business; and
- properly handle customer complaints.

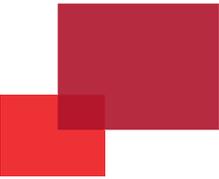
The Electricity Business Act allows METI to reject applications for various reasons, including where an applicant cannot demonstrate that it will have the ability to successfully conduct a retail electricity business or handle customer complaints or where the applicant is associated with anti-social forces. However, if METI identifies issues in an application, it will generally allow the applicant a reasonable chance to respond to its concerns by providing further information.

Where the applicant can meet the licensing requirements, METI will typically take around one month from submission of the application to reach a final decision. This period may be extended if METI has questions or concerns on any part of the application.

### **Are existing utilities obliged to allow new retailers to use their networks?**

Yes. The existing utilities, as network operators, are obliged to allow all retailers to use their transmission line networks. Under the Electricity Business Act, the utilities are not permitted to reject any request for use of their transmission lines absent justifiable reasons.

The utilities are, however, permitted to charge electricity retailers certain fees as wheeling charges (the levels of which are subject to METI's approval). In practice, this is done by the utilities charging retailers a per kWh fee for electricity wheeling services which retailers typically then pass on to their customers.



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Each utility has its own wheeling service terms and conditions (*takuso kyokyu yakkan*) which must also be approved by METI. New retailers are required to enter into a wheeling contract based on these terms and conditions before they can be provided with wheeling services.

**Does a wholesale electricity market exist, and if so, how well developed is it?**

For electricity retailers that do not have their own power generation sources, the main options to secure wholesale electricity supplies are:

- the Japan Electricity Power Exchange ("JEPX") wholesale market;
- direct transactions with independent power producers or JEPX members; or
- "anytime backup" by utilities (i.e., purchase of electricity from the utilities).

At present however, the quantity of electricity traded at JEPX is insufficient to create competitive pricing or to provide stable electricity supplies. This is a key issue for new retail entrants, particularly when compared to the amount of electricity traded in major wholesale exchange markets in Europe, such as the United Kingdom, Germany and Norway, where more than 50% of electricity generated is traded on the market.

At the same time, since the opening of the market in Japan, a number of electricity wholesale companies have expanded their business operations to supply electricity to new retailers. These include a number of companies that previously operated in the high-voltage industrial market. It is therefore possible for retail entrants to source supplies from such companies for onward sale to retail customers.

Unlike other markets, however, Japan has not reached the stage where electricity supply contracts are widely settled through financial swaps or other derivative transactions. This is an additional challenge for foreign retailers entering the Japanese market who are accustomed to such trading methods in their home countries.

**Future outlook**

Although the Japanese reform program is still in an early phase, much has been achieved in a short period of time. A number of further reform measures are expected to be implemented between 2017 and 2020 to increase the amount of electricity available for purchase on the wholesale market. These reforms are also seen as demonstrating the Japanese government's intent to successfully develop a competitive retail market. Much remains to be done, but the proposal of further changes is a positive sign for future progress in the Japanese power market.

We will continue to monitor developments in this area and provide further updates.

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