

Client Alert

May 2013

Investing in Japanese Solar Projects: Frequently asked legal questions from foreign investors

Japan's new solar project feed-in tariff system commenced operation on 1 July 2012 and has attracted a great deal of attention from international investors, many of whom are keen to enter the Japanese solar market.

Below we address some of the common questions asked by foreign investors interested in solar projects in Japan:

1. Can foreign investors establish or acquire solar energy projects in Japan?

Yes, foreign investors are able to establish and acquire solar energy projects in Japan. Foreign investors are able to hold a 100% interest in such projects (subject to the notification requirement in 2 below).

2. Are any special approvals necessary for foreign investors to participate in the solar energy business in Japan?

Any foreign individual or company wishing to operate an electricity generating business in Japan or wishing to acquire shares in a company carrying out such a business is required to give prior notification of such acquisition to the Bank of Japan (BOJ).

The Japanese government then has the right to notify the relevant foreign investor of its objection to such investment on national or economic security grounds.

In practice, the above requirement will generally operate more as a formality than a real impediment to foreign investors operating a renewable energy electricity business in Japan. We are not aware of any cases where the BOJ has objected to a foreign investor establishing a renewable energy generation project.

3. Can foreign investors directly own or lease land for solar projects?

Yes, foreign investors are free to either own or lease land in Japan for solar projects.

Restrictions exist in relation to using agricultural land for solar projects however, such restrictions apply equally to foreign and Japanese investors.

Various zoning rules will also affect whether a particular area of land may be used for solar projects. But again, such rules also apply equally to both foreign and Japanese investors.

4. What is the feed-in tariff price for solar projects in Japan?

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").

Solar projects of 10kW or more for which an application for consultation and grid connection was submitted to the electricity utility covering the project area by 31 March 2013 and which also received approval under the Renewable Energy Law before 31 March 2013 are eligible to enter into power purchase agreements ("PPA") with Japanese electricity utilities at a price of 42 yen/kWh over a PPA term of 20 years.

Solar projects of 10kW or more that did not receive approval under the Renewable Energy Law by 31 March 2013 can participate in the second feed-in tariff round from 1 April 2013 to 31 March 2014.

Projects of 10kW or more approved in this second round period will be eligible to enter into PPA's with Japanese electricity utilities at a feed-in tariff price of 37.8 yen/kWh for 20 years.

5. What are the key requirements to obtain the second round feed-in tariff price?

To secure the second round price of 37.8 yen/kWh for a 20 year PPA term, foreign investors must complete the following actions by 31 March 2014:

- (1) acquire firm rights to a project site (by either purchasing land, entering into a lease or obtaining a firm written commitment from a landowner to make a project site available);
- (2) submit an application for consultation and grid connection to the electricity utility that will purchase power from the relevant renewable energy project (i.e. the utility that operates in the geographical area in which the project is based); and
- (3) obtain approval for their generation facility from the Ministry of Economy, Trade and Industry ("METI") under Article 6 of the Renewable Energy Law.

Projects that complete the above steps by 31 March 2014 will be eligible to enter into a 20 year PPA with the relevant electricity utility at a price of 37.8 yen/kWh for 20 years.

6. Are there any special tax incentives for solar projects?

Yes, there are a number of tax incentives available for solar projects including:

- (1) a tax credit equal to 7% of the cost of relevant solar project equipment (available to small and medium size companies only);
- (2) accelerated depreciation allowances consisting of either:
 - an immediate 100% special depreciation of the full cost of the equipment; or
 - an immediate 30% special depreciation of the cost of the equipment and normal depreciation of the remaining cost over the normal depreciation period; and
- (3) a 1/3 reduction in the tax base (i.e. equipment value) for fixed asset tax purposes.

The above benefits are subject to certain conditions and requirements including specific deadlines to acquire project equipment.

The 100% special depreciation allowance may not be seen as particularly beneficial for foreign investors who do not have any other business operations in Japan generating existing income against which to utilize such depreciation.

7. Is it possible to purchase existing projects approved under the first round price of 42 yen / kWh?

Yes, it is possible to purchase the rights to projects that have secured the first round feed-in tariff price of 42 yen/kWh.

The transfer of ownership of such projects will not generally affect such project's right to enter into a PPA at the above price. However, careful consideration should be given as to whether to structure such purchase as an asset or share sale.

8. What are the challenges for foreign investors wishing to enter the Japanese solar energy sector?

Key challenges for foreign investors include:

- the project documents for Japanese solar projects will almost always need to be in Japanese;
- the need to conduct negotiations and business discussions in Japanese;
- the cultural challenge of dealing with rural communities and local governments to secure project land;
- Japanese project documents may generally not be as detailed as foreign investors may be accustomed to in their home jurisdictions; and
- the difficulty for foreign investors to obtain project financing without a track record in Japan.

For these reasons, many foreign investors try to team up with an experienced local partner or employ experienced local Japanese managers to assist in solar project establishment and operation.

Further updates

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

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