

## Making headway in Japanese offshore wind – bidder scrutiny of auction rules continues

MARCH 2021

## Auction guidelines face continued bidder scrutiny

**In our latest briefing on the Japan offshore wind market, we discuss the key themes and issues arising out of the latest public consultation between the government and potential bidders for the first round of fixed-bottom offshore wind farms in Japan**

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### Background

On 27 November 2020, the Ministry of Economy, Trade and Industry ("**METI**") and the Ministry of Land, Infrastructure, Transport and Tourism ("**MLIT**") (together, the "**government**") released the finalised auction guidelines for the first round of fixed-bottom offshore wind projects in Japan. Bids will be accepted by the government until 27 May 2021 (5pm).<sup>1</sup>

Alongside the publication of the finalised auction guidelines, the government released a first set of Q&A in respect of the public consultation regarding the previously published draft auction guidelines ("**Q&A#1**").<sup>2</sup> There were **1,324 submissions by 43 participants**, demonstrating a high level of engagement by the market. Please [click here](#) for our detailed briefing note on these submissions.

On 1 March 2021, the government released a second set of Q&A in respect of the auction guidelines ("**Q&A#2**").<sup>3</sup> There were **272 submissions** answered by the government in Q&A#2, which also included questions by bidders on the form of port lease contract (released by MLIT on its website in late December 2020).<sup>4</sup> This briefing note **focuses on the key themes and issues from Q&A#2** on which bidders appear to be focused at this stage of the bidding process.

### Japan's offshore wind "Round 1" projects



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<sup>1</sup> [https://www.enecho.meti.go.jp/category/saving\\_and\\_new/saiene/yojo\\_furyoku/dl/sentei/koubo\\_20201127.pdf](https://www.enecho.meti.go.jp/category/saving_and_new/saiene/yojo_furyoku/dl/sentei/koubo_20201127.pdf)

<sup>2</sup> <https://public-comment.e-gov.go.jp/servlet/Public?CLASSNAME=PCM1040&id=155201106&Mode=1>

<sup>3</sup> [https://www.enecho.meti.go.jp/category/saving\\_and\\_new/saiene/yojo\\_furyoku/dl/sentei/kouboFAQ\\_20210301.pdf](https://www.enecho.meti.go.jp/category/saving_and_new/saiene/yojo_furyoku/dl/sentei/kouboFAQ_20210301.pdf)

<sup>4</sup> [https://www.mlit.go.jp/kowan/kowan\\_tk6\\_000068.html](https://www.mlit.go.jp/kowan/kowan_tk6_000068.html)



## FIT TERM

By way of summary, the FIT term is 20 years from the scheduled operation date ("**SCOD**"), and the SCOD must be a date that is no longer than 8 years after the successful bidder notice is provided. The FIT term will be reduced to the extent that the actual commercial operation date ("**COD**") is delayed beyond the SCOD set out in the Occupancy Plan submitted by the bidder as part of its bid.

In Q&A#2, **bidders continue to focus on the limited circumstances in which the government may entertain an extension to SCOD**, demonstrating that a shortening of the FIT term remains a key risk factor for bidders. On this point, and in Q&A#1, the government has generally conveyed the message that any risk of delay to COD would be a risk for the successful bidder to manage.

In response to this position, question 5 in Q&A#2 raises the issue of delay in grid works undertaken by the local utility. This question focusses on the circumstances in which a local utility rejects the inclusion of any delay damages liability concept in its construction contract. The bidder points out that in this scenario, **the risk would no longer be capable of being managed by the preferred bidder** and accordingly asks whether the government would order the local utility to agree to the inclusion of delay damages in its contracts, or whether a delay to COD would otherwise be approved by METI for grid delay attributable to the utility (without a shortening of the FIT term).

The bidder comments that if neither of these options is available, **the successful bidder would be responsible for a risk it cannot manage** and, accordingly, SCOD would need to be set at the maximum 8 years, with this particular bidder seemingly being of the view that it would not be possible to propose an earlier SCOD due to this risk. In addition, it would not be possible to offer the lowest possible FIT (resulting in an increased burden on consumers).

**The government's succinct response was that it refrains from commenting on contracts between enterprises, confirming that it considers grid delay to be a bidder risk.**

Other related questions in Q&A#2 focus on the determination of the start date of the occupancy period, evidencing how focussed bidders are on timeline, presumably in no small part due to the very limited circumstances in which an extension to the SCOD will be granted.



## PORT USE ISSUES AND THE PORT LEASE CONTRACT

**Approximately 1/4 of the submissions of Q&A#2 concerned port use**, evidencing how port availability, suitability, restrictions and fees are a key focus for bidders at this point in time, with a particular focus on issues surrounding "overlapping use" of the ports.

It is worth reiterating that delays caused by overlapping use of the port by a separate successful bidder (in respect of a "renewable energy complex") remains the one possible avenue for a SCOD extension, so it is perhaps not surprising that there have been renewed bidder questions in this area.

Bidders in particular focussed on the content of the "**required discussions between the business operator and the government**" that would take place in the event of such aforementioned delay, and how long such discussions would be expected to take. The government replied **that the length of discussions would depend on the**

**circumstances, and that it would consider required changes to the occupancy plan in line with the auction guidelines.**

It is worth noting that some of the port related issues raised by bidders are addressed in the draft form of port lease ("**Port Lease**"), published on the MLIT website in late December of last year. **Article 44 of the Port Lease is of particular note**, as it would appear to be the government's response to requests from the industry to ensure that port related contracts cater for project financing (and, in particular, associated direct agreements).

**A number of questions in Q&A#2 concerned the Port Lease.**<sup>5</sup> One participant queried whether delays to the project which were due to the unforeseeable state of the leased property would result in an extension of the FIT term.<sup>6</sup> The government simply responded that **disputes between the parties would be resolved in accordance with the dispute resolution mechanisms in the Port Lease** (reinforcing how limited the circumstances are in which an extension to the SCOD will be considered by the government).

As mentioned above, several questions also concerned the issue of overlapping use and the way this is addressed in the Port Lease. Generally, the government's view is that the contract concluded first in time will prevail, but if the holder of the earlier lease changes its period of lease subsequently, the later contract would prevail.<sup>7</sup> A number of questions also concerned the calculation and payment of fees.

**Bidders also focussed on the content of the direct agreement** envisaged by Article 44, which seems to require a direct agreement only when parties A and B (i.e. MLIT and the port manager) deem the same to be "necessary", with a follow up query concerning whether or not parties A and B would agree to the inclusion of certain "market standard" project finance direct agreement provisions.<sup>8</sup>

In line with the government's favoured approach of giving itself leeway to consider each issue on merit at a future point, it simply **reiterated that whether a direct agreement was necessary (and the form of the same) would need to be discussed with parties A and B at the appropriate time.** However, the government does stress that the provisions of any direct agreement should not override the contents of the lease contract itself, and should not impose one-sided obligations on the government entities. **What this means in practice is unclear for now**, and we would expect follow-up questions to be raised in relation to this issue.

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<sup>5</sup> See questions 193 to 231.

<sup>6</sup> See question 199.

<sup>7</sup> See, for example, questions 206 and 207.

<sup>8</sup> See question 230.



## EVALUATION CRITERIA

A key area of focus of bidders in Q&A#2 relates to **how the government will implement the project implementation and local community / economic impact scoring system of the evaluation criteria, with roughly half of the submissions related to this theme.** The number of questions in this area perhaps displays a level of unease amongst the bidders with regard to the qualitative nature of Japan's offshore wind auction scoring system.

Many questions related to which entities making up the SPC / consortium (and which entities within the general corporate structure of applicants and members of the SPC or consortium) would be evaluated for the purposes of the scoring criteria.

For instance, given that the previous experience of entities which hold voting rights in the SPC will be the object of evaluation for the purposes of scoring the occupancy plan, **one bidder asked to what extent the proportion of voting rights in the SPC would be accounted for in the score.** The government replied that the occupancy plan should clearly indicate which entity plays which role in the project.<sup>9</sup> The government also reiterated that where the experience of several entities is put forward for the same role at the same time, the lowest experience score achieved by any of the relevant entities will generally be taken into account.<sup>10</sup>

However, the government also went on to say that **if the bid submission makes it clear in what way the joint role will be organised in terms of implementation, human resources and sharing of information, this organisational setup between the entities will be taken into account for the score.**<sup>11</sup>

As will not be surprising to any follower of the Japan offshore wind industry, the government is therefore seemingly giving itself a not insignificant level of flexibility to score the SPC/consortium members as it sees fit, on a case by case basis.

**Other questions focussed on how parent company experience would be evaluated** – the short answer being that if there is evidence that parent company experience is also the experience of the relevant entity (for example because of the way the parent and the subsidiary are organised and share information), then the experience of the parent company may be taken into account, but whether this scenario applies would (unsurprisingly) be judged on a case-by-case basis.<sup>12</sup>

Bidders have attempted to procure clearer guidance from the government in terms of the exact criteria that would be used to determine when experience of other group members within the corporate structure would be taken into account, **but the government is reserving its room for deciding each case on its own merits.**

**Bidders are obviously keen to understand where they might be able to use the previous experience of parents and subsidiaries to achieve an improved score,** and wish to avoid a scenario where the lowest score of several entities put forward for a particular role is adopted in the final assessment. However, it seems that the government

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<sup>9</sup> See question 33.

<sup>10</sup> See, for example, questions 108 and 154.

<sup>11</sup> See, for instance, questions 86, 92, 94 and 98.

<sup>12</sup> See questions 94 and 102.

is again keen to not limit its ability to decide the score of each submission on its particular merits.

Separately, it is interesting to note that, compared to Q&A#1, there are now fewer questions<sup>13</sup> around the sell-down categories of equity which the government had previously singled out as not generally being permissible, which suggests market participants are now to some extent comfortable with the restrictions around the sell-down of equity, or have otherwise decided that they are able to structure based on the government advice to date and the auction rules.



## FIT TARIFF AND FIT APPROVAL

In comparison to Q&A#1 **there were notably fewer questions on the FIT ceiling price of 29 JPY/kWh**, suggesting that bidders are becoming more familiar with how this price was calculated (with some bidders perhaps retaining their objections to the level of the ceiling price itself).

However, a number of FIT related questions did enquire about a scenario where a selected bidder has entered into several connection agreements, and whether a different SCOD could be set for each of these connection agreements (a possibility the government had previously confirmed as acceptable to bidders). In response to these queries, the government confirmed that the FIT approval process **would be carried out separately for each connection agreement** (and that each would be the subject of a separate 20-year FIT term).<sup>14</sup>

In addition, there are several questions about the requirements for the FIT approval application procedure, which remains to be published.<sup>15</sup>

**The government plans to publish this information on the website of the Agency for Natural Resources and Energy as soon as possible, although no specific time frame was given for such publication.**



## INCUMBENT DEVELOPERS

We highlighted in our previous Japan offshore wind update that **the auction rules do not contain any clear protections for incumbent developers**, or address their position (with the exception of the transfer mechanism in the rules concerning grid connection rights). **This topic emerges once again in Q&A#2.**

Bidders are seemingly attempting to ascertain to what extent an incumbent developer, who would have already invested significant time and resources into stakeholder relationships, would have an advantage due to its longer established connections to the region.

During Q&A#1, the government had previously stated that it might also take into account the time invested. A bidder picked up on these previous responses by the government in Q&A#1, and stressed that efforts by incumbent developers and the understanding such developers already have with (for example) the fishery community must form part of

<sup>13</sup> Questions 33, 34, 63, 84, 86, 123, 124, 125, 140.

<sup>14</sup> See questions 6 and 8.

<sup>15</sup> Questions 18 and 126.

their score in the bidding process.<sup>16</sup> The government replied that if the occupancy plan aligns with the opinion of the local council (set up in each promotion zone), **then it would be possible that this is taken into account for the score in relation to the degree to which the occupancy plan is realistic.**

This general reference to the provisions of the auction guidelines highlights once again that the government does not want to restrict itself and will consider each submission on a case-by-case basis.

In its responses in Q&A#2, the government also encouraged bidders to include any items demonstrating the ability to create long-term and well-coordinated relationships with the local government bodies. It also stressed that only the experience of the auction applicant itself (and, if an SPC or consortium, the experience of the members) will count in this area. **It seems that this is the furthest the government is prepared to go in terms of recognising the efforts made by incumbent developers at this stage,** and incumbent developers will largely have to wait and see whether their efforts to date will be rewarded by a higher qualitative score when compared to bidders who may not be as well known to the local community for example. For context on this point, it is perhaps worth mentioning as a reminder that **the auction rules provide for a maximum of 40 points in respect of local community / economic impact, out of an overall score of 240 points.**



## LOCAL COMMUNITY AND FISHERIES

**Relationships with the local community, and the local fishery bodies in particular, formed the basis of a large number of questions in Q&A#2.<sup>17</sup>**

Government responses, as a general theme, **emphasised the importance of establishing good relationships with the local community** to ensure the long-term implementation of the project (and that any evidence of efforts made in relation to this should be included in the bid submission where bidders believe they have had relevant achievements in this area). Bidders also asked how widely "region" would be defined in terms of assessment of the impact on the local economy of the region. The government replied that while it did not intend to impose a limiting definition, the opinion of the prefectural governor would be taken into account as representative of the relevant region.

Bidders also queried the requirement for obtaining the understanding of the local fisheries (which are part of the relevant local council set up for each zone) prior to the application for the occupancy permit. The government reiterated that this is at the discretion of the relevant fishermen.

**A number of questions then related to the contributions to the fund for the benefit of the local region and fishery industry** – an ongoing concern of many bidders it would seem. The government clarified that, given the exact amounts etc will be discussed with the local council following selection, at bid submission stage a reasonable estimate of contributions will be sufficient.

There were several questions on this topic in relation to the individual promotion zones.<sup>18</sup> For example, regarding Noshiro, a bidder queried how the position of wind

<sup>16</sup> See question 78.

<sup>17</sup> Question 61, 62, 65, 66, 70, 71, 72, 78, 81, 82, 83, 101, 128, 129, 131 and 133.

<sup>18</sup> Question 236 and following.

turbines could be determined, following an explanatory meeting of the local council during which it had been stressed that before installing the turbines, the location of the turbines should be discussed with fishery personnel (which would seem to contradict the rule that contact between bidders and local officials at this stage is not permitted).<sup>19</sup>

The government reiterated that, in line with the summary of the opinion of the local council attached to the auction rules, **the placement of turbines would need to reflect that the local fisheries have been taken into account and sufficient explanation to the fisheries carried out.** However, contact with the relevant fishery personnel during the auction process would not be envisaged. Whether or not this response satisfied the bidder who raised the question is open for debate.

**There were also participant concerns as to the level of contribution to the fisheries and local community fund – an ongoing theme of the auction rules for some time now.**

For Noshiro<sup>20</sup>, bidders generally queried whether the amount contributed (which the auction guidelines had estimated 0.5% of the income from the sale of electricity over 20 years) might exceed the 0.5% mark annually as a result of the deliberations of the local council. Bidders also queried whether operations would have to be stopped if agreement could not be reached.

**The government replied that given the estimate was 0.5% of sales over the 20 year period, the contribution would not necessarily be exactly the same each year.** In addition, the government highlighted that the selected bidder itself would become a member of the council. There were also numerous queries concerning how the amount of contribution was to be estimated at bidding stage and consequences if the actual amount of contribution were to exceed the estimate at bidding stage (or the actual income from sales to differ from the estimate).

The government reiterated that **details of the fund contributions would be settled after discussion with the council following selection of the successful bidder.** Similar concerns were raised by participants regarding Yurihonjo<sup>21</sup> and Choshi<sup>22</sup>.

**Uncertainties around the level of contribution to the fund therefore seem set to continue for the foreseeable future.**



## DECOMMISSIONING

**Decommissioning costs and associated security continue to attract many questions from bidders.**<sup>23</sup>

The government reaffirmed that the detailed methods and detailed costs of decommissioning would not need to be included for the bid submissions (and indicating whether a bidder planned to remove all equipment or only part of the plant would suffice), and would be covered in amendments to the occupation plan prior to beginning of construction.

<sup>19</sup> See question 251.

<sup>20</sup> See questions 243 – 248, 250, 253.

<sup>21</sup> See questions 257 – 263.

<sup>22</sup> See question 268.

<sup>23</sup> See questions 19 – 25, 55, 57, 104, 105, 132.

**The cost of decommissioning should be assumed to be 70% of the offshore construction costs for the purposes of bid submissions.** However, the government stressed that this only applies to the offshore renewable energy generation facilities: the cost of removal of any other facilities will form part of the assessment as part of the income and expenditure plan (and, depending on the individual case, the economic effect on the region and the country).<sup>24</sup>

There were also several questions about the technicalities surrounding the decommissioning security (or reserves, as applicable). The government also confirmed that the letter of interest for any decommissioning LC or guarantee would not need to state the exact amount. Decommissioning method and costs will need to be assessed in detail (and corresponding changes made to the occupancy plan) prior to the start of construction.



## ADDITIONAL POINTS OF INTEREST

We also note the following points raised in Q&A#2, which may be of interest to market participants:

- The government has clarified that electricity **can only be sold to the relevant local utility**.<sup>25</sup>
- A **very low FIT put forward may count against the bidder** if the government considers that, in reality, it would be difficult for the bidder to achieve a profit.<sup>26</sup>
- Pre-COD generation:<sup>27</sup> it seems that it will **not be possible for selected bidders to sell any electricity generated during trial runs prior to COD**. This attracted some unhappiness from bidders, who highlighted that pre-COD generation can be sold for onshore wind and solar, but the government referred back to the previous relevant committee determinations on this point.
- Several participants raised questions on the security.<sup>28</sup> In particular, due to the bid configurations possible for Yurihonjo (North, South and both zones together), one bidder asked whether (if bidding for both zones at once as well as the North zone separately) separate guarantees would be required. **The government confirmed that if a guarantee for both zones is submitted, no separate guarantee for the North zone would be required.** There were also several questions surrounding the detailed forms and procedure for the guarantees.
- With regard to bids that have been prepared using the bidder's own original data (rather than the data offered by the government), the government was asked **whether there was a risk that it would view the bidder's own data as unreliable in the event of there being a material discrepancy between the bidder's own data and the government's data**, and whether this might then result in a lower score. In response, the government stated that there **may be cases where a low score is given if the occupancy plan is clearly unrealistic on the basis of the government's survey results.**

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<sup>24</sup> See question 21.

<sup>25</sup> Question 1.

<sup>26</sup> Question 2.

<sup>27</sup> Questions 3 and 4.

<sup>28</sup> Questions 35 – 44.

- We also note that several participants asked how subcontracts for implementation would be assessed, **suggesting that multi-contract procurement models may be adopted by particular bidders.**<sup>29</sup>
- The version of Q&A#2 published on the METI website contains an introductory note which states that METI is "*unable to answer questions about the provision of information obtained through national surveys, as this information is subject to confidentiality. Please contact us separately via the applicant of the confidential information*". **Bidders should therefore bear this in mind if it had particular questions or concerns with regard to national surveys.**
- The government affirmed that **changes to the occupancy plan might be permitted to reflect both a change to the model as well as to the maker of the wind turbine** (as long as the conditions for a change to the occupancy plan as set are fulfilled).



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<sup>29</sup> Questions 48 – 50, 75, 89, 90, 110.

## Concluding remarks

The focus of bidders in Q&A#2 has moved away from material concerns with the FIT ceiling price of 29 JPY/kWh and the restrictions on the sell-down of equity. While bidders may of course retain a degree of concern in relation to these two key areas, they are not (at least through the formal Q&A public consultation process) seeking on a material level to raise further objections with the government on these topics.

However, **the lack of protection with regard to any delay to the commercial operation date that is outside of bidder control evidently remains a key concern of the bidding community.** The government has been steadfast in its responses

to the high volume of bidder questioning in this area - no extension to the FIT term will be afforded in the event COD is delayed beyond SCOD (other than the limited exception discussed above with regard to any overlapping use of the applicable port by another successful bidder). Presumably the government considers that the competitive tension present in the market will be sufficient to mitigate the risk of all bidders simply (a) specifying a SCOD that is the maximum length allowed under the auction rules (i.e. 8 years from the date of the successful bidder notice), and/or (b) bidding the ceiling price of 29 JPY/kWh, in order to mitigate the risk of delay which is outside of its control. **It will be interesting to see whether bidders are prepared to bid a shorter COD or not.**



*Bidders are focusing on how the government will interpret the qualitative aspects of the auction scoring system*

the number of submissions in Q&A#2 that bidders' concerns in relation to port use and development remain. **Such concerns would seemingly need to be taken into account in the determination of each bidder's SCOD.**

Following on from Q&A#1, **the number of submissions in Q&A#2 relating to the fishing industry and fund demonstrate that this topic remains a key area of focus for the bidding community.** It would seem however from the government responses to these submissions that it will be sometime before we see clarity emerge with regard to issues such as fishing fund contributions.

Lastly, and as a general comment, it is clear from a review of the submissions in Q&A#2 that particular bidders are **focusing intently on how the government will interpret the qualitative aspects of the auction scoring system.** In general, the government's position is that it will be assessing occupancy plans on a case by case basis, and it notably stayed away from providing bidders with any clear cut position on the specific queries raised in this area. This is not surprising, and fits in with the **theme of the government consistently giving itself broad discretion to consider the merits of each point in question on a case by case basis.**

With bid submissions due in May of this year, exciting times lie ahead for the industry in Japan. If you would like to discuss any point raised in this briefing note in further detail (or any of our other previous briefing notes on offshore wind in Japan<sup>30</sup>), **please do not hesitate to get in touch** with any of the Ashurst Japan offshore wind team (details below). We would be delighted to hear from you.



*Bidder attention now seems to be firmly placed on key practical issues such as the scheduled date for completion, adequacy and availability of port facilities, and interaction with the local community*

In addition to the key concern around the SCOD, **bidder attention seems to now be increasingly focussed on the use and adequacy of the applicable port.** Publication of the draft lease port contract has gone some way to answering a number of bidder questions in this area, but it is clear from

<sup>30</sup> ["Making headway in Japanese offshore wind - Japanese parliament passes Offshore Wind legislation"](#) ; ["Making headway in Japanese offshore wind - one year on"](#); ["Making headway in Japanese offshore wind - Auction guidelines face bidder scrutiny"](#); and ["Offshore Wind in Asia: Recent Developments and Future Opportunities"](#)



## ASHURST KEY CONTACTS FOR OFFSHORE WIND IN JAPAN



**David Wadham**  
Managing Partner, Tokyo

T +81 3 5405 6203  
M +81 90 4828 5191  
[david.wadham@ashurst.com](mailto:david.wadham@ashurst.com)



**Frédéric Draps**  
Partner, Jakarta

T +62 212 996 9250  
M +62 811 962 05060  
[frederic.draps@ashurst.com](mailto:frederic.draps@ashurst.com)



**Kensuke Inoue**  
Partner, Tokyo

T +81 3 5405 6223  
M +81 90 5190 0360  
[kensuke.inoue@ashurst.com](mailto:kensuke.inoue@ashurst.com)



**Peter Grayson**  
Senior Associate, Tokyo

T +81 3 5405 6088  
M +81 80 8053 9933  
[peter.grayson@ashurst.com](mailto:peter.grayson@ashurst.com)



**Chiharu Takatori**  
Associate, Tokyo

T +81 3 5405 6082  
[chiharu.takatori@ashurst.com](mailto:chiharu.takatori@ashurst.com)



**Eva Zimmermann**  
Associate, Tokyo

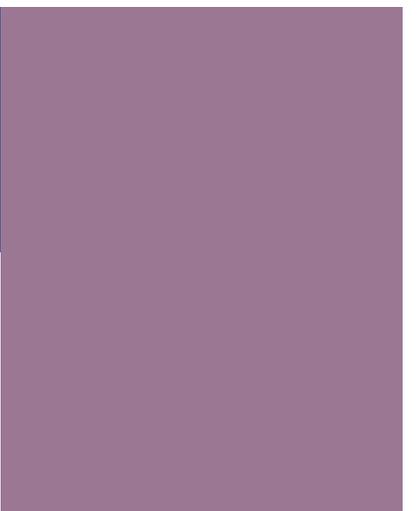
T +81 3 5405 6217  
M +81 80 2561 6218  
[eva.zimmermann@ashurst.com](mailto:eva.zimmermann@ashurst.com)

[www.ashurst.com](http://www.ashurst.com)

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