NEWSLETTER

NISHIMURA & ASAHI

Offshore Wind Auctions in Japan – Guideline Changes for Round Four

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Ⅰ Introduction

On December 24, 2024, the results of Japan's third round of offshore wind auctions[1] were announced, with two fixed-bottom offshore wind sites awarded.[2] A consortium consisting of JERA, Green Power Investment, and Tohoku Electric was selected to operate a 615 MW offshore wind farm off the coast of Aomori (Aomori Prefecture), and another consortium consisting of Marubeni Corporation, Kansai Electric Power, British Petroleum, Tokyo Gas, and Marutaka Corporation was selected to operate a 450 MW offshore wind farm off the coast of Yuza Town (Yamagata Prefecture). Both projects are set to start commercial operations in June 2030.

On January 29, 2025, the Ministry of Economy, Trade, and Industry ("**METI**") and the Ministry of Land, Infrastructure, Transport and Tourism ("**MLIT**") published revised Guidelines for the Operation of Public Tenders for Occupancy of General Waters ("**Operational Guidelines**") applicable to the fourth auction round.[3]

The revised Operational Guidelines address challenges identified in the previous auction rounds and concerns raised by developers, with the goal of increasing fairness and efficiency in the bidding process. The key changes include a revised scoring system for proposed commercial operation dates ("**COD**") that reduces point margins for CODs exceeding 5 years and 6 months, and increased points available for the bidders' financial plan and project plan prior to the COD to enhance focus on risk management. In addition, the revised Operational Guidelines introduce higher security deposits to be paid by bidders, with incremental forfeiture penalties for delays, reduced point margins between bid prices, and a new adjustment mechanism reflecting capital

1 For an overview of offshore wind auctions in Japan, please refer to Nishimura & Asahi, *Finance Law Newsletter*, April 28, 2023, The Second Round of Offshore Wind Tenders in Japan (Updates from the First Round), and Globe Business Publishing, Nishimura & Asahi, *International Law Office Energy & Natural Resources Newsletter*, July 19, 2021, Offshore wind bidding for round 1 areas in Japan.

2 https://www.meti.go.jp/press/2024/12/20241224002/20241224002.html

3 https://www.meti.go.jp/press/2024/01/20250129003/20250129003.html

expenditures ("**CAPEX**") fluctuations in the feed-in premium ("**FIP**") base price.

This newsletter summarizes the key changes to the Operational Guidelines in detail, and discusses other factors that may affect bidding behavior and project execution in the upcoming auction round.

II Background

1. Offshore Wind Auctions in Japan

The Japanese government has set a target of 10 GW of offshore wind capacity to be allocated by 2030 and an ambitious goal of achieving carbon neutrality by 2050, with the promotion of offshore wind as one of the key elements of its carbon neutrality plan.

In furtherance of that goal, the Act on Promoting the Utilization of Sea Areas for the Development of Marine Renewable Energy Power Generation Facilities ("**Act**"), which came into effect on April 1, 2019, introduced a system to identify and categorize potential offshore wind development areas, which initially are classified as preparation zones, later as promising zones, and finally as promotion zones. The preparation zones are in the earliest stage of development and require further environmental assessments, feasibility studies, and stakeholder consultations before they can be considered for tenders. The promising zones are in the advanced stage of assessment, with ongoing wind and geological surveys, established local coordination councils, and grid capacity under review. While the promising zones are not ready for public tender, they are candidates for future auction rounds. Once an offshore wind development area reaches the promotion zone stage, it can be auctioned.

A total of approximately 2.76 GW of offshore wind capacity was awarded in the first three auction rounds.

The promotion zones for the upcoming fourth auction round have not been announced; however, the Japanese government has announced five promising zones and eleven preparation zones. All five promising zones, which are potential candidates for the fourth auction round, are off the coast of Hokkaido, including Matsumae, Gan'u-Minamishiribeshi, Hiyama, Shimamaki, and Ishikari.

2. Operational Guidelines and the Score Allocation System

The Operational Guidelines were first published in June 2019 in connection with the first auction round and were revised substantially in October 2022 in connection with the second auction round. In 2024, the third auction round was conducted without any further changes to the Operational Guidelines.

Bids for the development of promotion zones are evaluated on a scale of 240 points, with 120 points available based on the proposed supply price of electricity (price-based scoring) and 120 points available based on various evaluation criteria related to project implementation and feasibility (non-price-based scoring).

For price-based scoring, each bidder can be awarded up to 120 points based on the proposed supply price of electricity. The maximum score of 120 points is awarded if the proposed FIP price is at or below a certain price, which is sufficiently below the 'market price' ("**Zero-Premium Level**"). Since the second round, the Zero-

Premium Level has been set at ¥3/kWh.

For non-price-based scoring, each bidder can be awarded up to 80 points for various evaluation criteria related to project implementation and feasibility, and up to 40 points for coordination with regional stakeholders and economic ripple effects. For each non-price-based criterion, each bidder is evaluated and ranked on a six-level scale, in which each level corresponds to a specific number of points: (i) top runner, (ii) excellent, (iii) middle runner, (iv) good, (v) minimum required level, and (vi) disqualification.

III Guideline Changes

The revised Operational Guidelines introduce the following key changes, which will be described in more detail below:

(1) A new scoring system that promotes a feasible COD by reducing the point margins for CODs exceeding 5 years and 6 months as part of the non-price-based scoring.
(2) An increase in the points awarded to the top runners for their financial plans and project plans prior to COD, as part of the non-price-based scoring, enhancing the focus on risk management.
(3) An increase in the second- and third-stage security deposits to be paid by the bidders, along with a new system of forfeiture penalties for delays.
(4) A new scoring system for price-based scoring, which reduces the point margins between Zero-Premium Level bids and higher bids.
(5) A new adjustment mechanism that reflects CAPEX fluctuations in the FIP base price.

1. Early COD

There are 20 points available for the proposed COD of a bid, which is one of the various evaluation criteria related to project implementation as part of the non-price-based scoring. Under the previous Operational Guidelines, 20 points were awarded if the proposed COD was before certain dates set for each promotion zone, and the number of points would decrease proportionally, in 1-year increments, from the set dates until the end of FY2030. If the proposed COD was later than the end of FY2030, no points would be awarded.

Under the revised Operational Guidelines, the maximum score of 20 points will be awarded if the proposed COD is within 5 years and 6 months of the award date. There will be a deduction of 2 points for each 6-month delay, i.e., if the proposed COD is after 6 years, 18 points will be awarded, and so forth, until the 10 year mark.

The specific expected operation dates for each promotion zone, which were based on the grid and availability of the ports, are no longer used, and the same lead time benchmark score now applies across all promotion zones. As an alternative, bidders later can choose to use ports other than those assumed at the time of the auction.

This evaluation system for COD may be reviewed and adjusted if it does not work as expected. For example, if it is apparent that it will take longer than 10 years to commence operations, the evaluation method could be reconsidered.

2. Risk Management

In the second and third auction rounds, bidders were required to provide descriptions of how they would manage specific risks mentioned in the Operational Guidelines. To obtain the “top runner” score, bidders also were expected to independently identify, analyze, and propose countermeasures for risk scenarios in addition to those mentioned in the Operational Guidelines.

Pursuant to the revised Operational Guidelines, the bidders with the strongest plans for mitigating the specific risks outlined in the Operational Guidelines will be awarded the highest scores. These risks include inflation, construction delays, and shortages of workers and materials. Recent challenges in the global offshore wind market have made it clear that these risks are the most critical to ensuring successful project implementation.

To encourage more robust project plans and timely achievement of project CODs, the available points related to non-price-based scoring for each bidder have been adjusted under the revised Operational Guidelines, as follows. The points available for the financial plan have been increased from 10 to 14, and for the project plan prior to COD from 15 to 16. By contrast, the available points for the organizational plan have been reduced from 10 to 6, and for the project plan after COD from 5 to 4.

With regard to the financial plan and the project plan prior to COD, only the top runners will be awarded an increased number of points, while the other levels (such as excellent and middle runner) will be awarded the same points as in previous auction rounds, thereby increasing the point margin between top runner level and excellent level.

The increase in available points for risk management will enhance the focus on projects’ resilience against inflation and reward the projects with the most robust financial and risk management plans. While these changes modify the assessment approach for risk scenarios, the responsibility for managing these risks remains with the bidders.

3. Security Deposits

Similar to previous auction rounds, bidders are required to submit security deposits in three stages based on the power output of the offshore wind farms. In the revised Operational Guidelines, the first-stage security deposit to be paid by the bidders at the time of bid submission will remain ¥500/kW, but the second-stage security deposit to be paid by the winning bidders within 8 weeks of the award has been increased from ¥5,000/kW to ¥10,000/kW, and the third-stage security deposit to be paid by the winning bidders within 24 months of the award has been increased from ¥13,000/kW to ¥24,000/kW.

These increases are designed to prevent business withdrawals and project delays, as well as to ensure successful implementation of offshore wind projects, drawing on similar international systems as a reference.

The revised Operational Guidelines also include changes to the forfeiture rules for bid security deposits. Previously, the second- and third-stage security deposits would be forfeited in full if operations did not commence by the proposed COD. Under the revised Operational Guidelines, the forfeiture amount will be

increased incrementally every 6 months, rather than the entire amount being forfeited at once. The forfeitures will not follow a simple linear increase; instead, larger forfeitures will result from longer delays. For delays of less than 6 months, ¥4,000/kW will be forfeited, between 6 months and 1 year, ¥8,000/kW will be forfeited, between 12 and 18 months, the forfeiture will range from ¥8,000/kW to ¥16,000/kW, between 18 and 24 months, the forfeiture will increase to ¥20,000/kW, and for delays exceeding 24 months, the full deposit of ¥24,000/kW will be forfeited.

Although the criteria for forfeiture have been eased, the higher security deposits will encourage businesses to develop projects rapidly, in accordance with public occupancy plans, while also exposing them to the risk of substantial forfeitures if there are delays.

4. The Quasi-Zero Premium Level

In previous auction rounds, the bid with the lowest price was awarded the maximum score of 120 points. Bids priced at twice the amount of the lowest bid were awarded half of the maximum points (i.e., 60 out of 120 points), while bids priced three times higher were awarded one-third of the maximum points (i.e., 40 points).

The revised Operational Guidelines introduce the concept of a quasi-zero premium level ("**Quasi-Zero Premium Level**") in addition to the Zero-Premium Level, to mitigate the sharp decline in points awarded as bids move away from the Zero-Premium Level. Bids at the Zero-Premium Level represent a scenario in which no additional financial support is provided for the project beyond the market price for the generated electricity, whereas bids at the Quasi-Zero Premium Level allow some flexibility for projects that require additional costs but are still competitive.

The Quasi-Zero Premium Level is set by reference to the national average market price for wind power over the past 3 years, and represents a standard price level at which no premium income is generated, assuming average market conditions. The Quasi-Zero Premium Level is expected to be set at ¥14/kWh and will be revised for each auction round as needed based on market conditions.

Under the revised Operational Guidelines, a bid at the lowest price or at the Zero-Premium Level will be awarded the maximum of 120 points, and from there, the points will decrease in a linear manner until the Quasi-Zero Premium Level is reached, at which point the bidder will be awarded 104 out of 120 points. The points also will decrease in a linear manner until the maximum bid price set by METI is reached, which will not be awarded any points. The maximum bid price has not been set at this time. As a result, the point margins between the Zero-Premium Level and the Quasi-Zero Premium Level will be smaller than under the previous versions of the Operational Guidelines.

5. Price Adjustment Mechanism

The revised Operational Guidelines introduce a new price adjustment mechanism, pursuant to which the FIP base price will be subject to a one-off adjustment after the bidding process.

The purpose of this price adjustment mechanism is to adjust for CAPEX fluctuations, as CAPEX changes can have a significant impact on a project's feasibility. If costs increase between bid submission and construction,

the FIP base price will be adjusted to reflect these changes.

The adjusted FIP base price will be calculated by multiplying the FIP base price by a price fluctuation rate. The price fluctuation rate is determined by comparing prices from the bid submission to the start of construction based on certain price indexes. The percentage difference in prices is then multiplied by 70% to reflect the CAPEX ratio.[4] The fluctuation rate will be subject to upper and lower limits to prevent excessive costs. The specific percentages for both the upper and lower limits will be determined by the Procurement Price Calculation Committee.

IV Outlook

Several factors are expected to influence the upcoming fourth auction round. While the revised Operational Guidelines have introduced adjustments aimed at addressing past challenges, other general developments related to the offshore wind auction also are likely to affect bidding strategies and project execution.

The following sections discuss two key factors that may affect bidding behavior and project execution: (i) the impact of the Quasi-Zero Premium Level and the Zero-Premium Level projects' potential participation in the capacity market, and (ii) the possibility of changing wind turbine suppliers.

1. Impact of the Quasi-Zero Premium Level and Participation in the Capacity Market

In previous auction rounds, bidders competed aggressively to secure the highest price score (120 points) by submitting bids at the Zero-Premium Level. Bids higher than the Zero-Premium Level were awarded significantly lower points, effectively making it impossible for bidders to recoup points through the non-price-based score. However, as the point margins under the revised Operational Guidelines are smaller, the pressure to bid at the Zero-Premium Level is expected to be less significant in the upcoming auction rounds.

On February 26, 2025, a working group committee announced that projects bidding at the Zero-Premium Level will be allowed to participate in the capacity market's main auction during the FIP program period, provided that the bidders waive the portion of their FIP payments equivalent to the balancing cost, i.e., the cost related to maintaining a balance between planned generation of electricity and the actual generation of electricity.[5]

Projects receiving support under the feed-in tariff ("**FIT**") or FIP scheme generally are not allowed to participate in the capacity market during the FIT or FIP period, as it could lead to double compensation. Double compensation occurs when projects receive payments from both the FIT or FIP system (fixed payments for generated electricity) and the capacity market (which compensates projects for being available to supply electricity, whether or not electricity is generated).

However, projects with bids at the Zero-Premium Level differ from typical FIP-supported projects, as they only receive payments based on the market price of the electricity they generate, with no additional premiums on top of the market price. Since these projects do not receive fixed payments under the FIP system beyond the

[4] Based on METI's evaluation of previous auction rounds, CAPEX constitutes 70% of the total costs of large-scale offshore wind projects.

[5] https://www.meti.go.jp/shingikai/enecho/denryoku_gas/denryoku_gas/seido_kento/100.html

market price, there is no risk of double compensation if they also receive payments from the capacity market.

The projects with bids at the Zero-Premium Level are expected to be able to participate in the capacity market in the fourth auction round. While the importance of bidding at the Zero-Premium Level to be awarded the maximum points may decrease, the incentive to earn additional payments through the capacity market will make Zero-Premium Level bids more attractive. This could influence bidding strategies and potentially undermine the intended impact of the smaller point margins introduced in the revised Operational Guidelines.

2. Change of Wind Turbine Suppliers after the Award

When submitting a bid, bidders must present a public occupancy plan setting out the details of the proposed project, which will be considered when evaluating the bids to determine the winners. To maintain fairness and ensure that bidders do not change the public occupancy plan after winning a project, there is limited ability to make amendments to the public occupancy plan after the auction. Under the Act, a change to a public occupancy plan may be approved only if it serves the public interest or is due to unavoidable circumstances.

After the second auction round, certain bidders suggested that the rules for changing the wind turbine supplier after winning the project should be more flexible. The Japanese government has clarified that changing the wind turbine supplier may qualify as “unavoidable circumstances” if (i) continuing the business is difficult, such as when the risk scenario described in the tender documents is dramatically exceeded due to inflation, or (ii) if the wind turbine supplier offers to cancel the contract as a result of price negotiations, etc., the situation may force the bidder to make changes in order to continue the business.

Changes to wind turbine suppliers may impact the environmental impact assessments and wind farm certifications, potentially delaying the COD by 1-2 years and thereby reducing the evaluation score for early COD. As a result, METI and MLIT will require bidders seeking such changes to implement measures to compensate for the lower evaluation score, such as enhancing the stability of the power supply through strengthening the supply chain.

V Concluding Remarks

In recent years, global market conditions for offshore wind projects have faced headwinds, including rising capital costs, supply chain bottlenecks, and higher interest rates, resulting in several projects being suspended or withdrawn.

The key changes to the Operational Guidelines address these challenges by improving the overall scoring systems, enhancing the focus on bidders’ risk management, reducing point gaps for COD and bid prices, changing the security deposit structure, and reflecting CAPEX fluctuations in the FIP base price. These changes aim to increase project feasibility and the probability of realization, and to incentivize bidders to propose realistic CODs.

In addition to the revised Operational Guidelines, other developments are likely to influence bidding strategies and project execution. The potential for capacity market participation could incentivize more bids at the Zero-Premium Level, potentially reducing the effects of the new scoring system for bid prices. However, the additional

revenue from participating in the capacity market may be limited, and there may not be sufficient incentive to bid at the Zero-Premium Level. The clarified approach to changing wind turbine suppliers may offer more flexibility for the developers in the period after the award.

With the upcoming fourth auction round, the industry will be observing how the recent updates to the Operational Guidelines impact the bidding process and evaluations going forward. The revised Operational Guidelines encourage more feasible projects, but their success will largely depend on how developers respond. Meanwhile, the Japanese government continues to prepare and select new offshore wind sites, which will be essential for achieving Japan's aggressive goal of carbon neutrality by 2050.

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