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METI Proposes Price Cap Reductions in Japan's Balancing Market: Implications for Battery Energy Storage Systems

The Japanese Ministry of Economy, Trade and Industry (METI) has proposed revisions to the price cap structure in Japan's balancing market that may materially impact the economics of battery energy storage system (BESS) projects in Japan.

Under proposals presented to METI's System Review Working Group in late October 2025 (the METI proposal), from April 2026 onward the price cap for premium balancing products (Primary, Secondary-1, and composite products) will be reduced from JPY 19.51 to JPY 7.21 per ΔkW/30min, a reduction of approximately 63%. This harmonizes the cap with the lower-value Secondary-2 and Tertiary-1 products, effectively removing the premium previously assigned to faster-response products in the balancing market. The METI proposal comes against a backdrop of concern that many faster-response balancing market bids have clustered at the price ceiling, leading to high balancing costs. These changes, together with recent changes in the Long-Term Decarbonization Power Source Auction (LTDA) 2025–26 auction guidelines, may signal a shift in METI and Organization for Cross-regional Coordination of Transmission Operators (OCCTO) priorities towards promoting long-duration, long-term capacity, in lieu of fast-response systems in the balancing market with potentially high-value arbitrage upside. This shift may affect Japan BESS project economics and market participation and future investment decisions in Japan's BESS development.

Background on Japan's Balancing Market

Purpose and Market Structure

Japan established its balancing market in April 2021 as part of the country's broader electricity market reforms, designed to facilitate cross-regional procurement of balancing capacity and reduce adjustment costs through market-based competition and transparency. The Electric Power Resources Exchange (EPRX) hosts the market, through which transmission system operators across Japan's nine electricity regions procure ancillary services. The EPRX aims to maintain grid stability by ensuring adequate reserve capacity to address supply-demand imbalances, which is becoming particularly critical as Japan increases renewable energy penetration toward its target of 36–38% by 2030.

The balancing market may be called upon to adjust supply/demand in real time to balance capacity for regional supply/demand frequency control. Participants, including power producers, battery operators, and demand-response providers, bid into this market to offer adjustment capacity. When the system operator requires adjustment capacity, those who have offered such capacity get dispatched and paid based on the clearing price in the market. This clearing price is subject to certain price caps that limit the maximum price per ΔkW/30min.

Product Categories and Proposed Changes to Price Caps

The Primary product market is the fastest response layer, utilizing Governor Free (GF) control to respond automatically to frequency deviations within 10 seconds.

The Secondary-1 product market is a "fast" secondary layer which utilizes Load Frequency Control (LFC) signals to address short-cycle fluctuations (seconds to minutes). Resources must follow automatic server signals sent every few seconds to correct frequency noise.

The Secondary-2 product market is a "slow" secondary layer which utilizes Economic Dispatch Control (EDC) signals to address long-cycle fluctuations (trends and forecast errors). While it must also be activatable within five minutes, it receives set-point instructions less frequently than Secondary-1, serving to reload the faster Secondary-1 reserves.

The Tertiary product markets are slower reserves (15–45-minute response) used to replace secondary reserves and handle major imbalances.

The following table sets forth the current price cap structure for these products and METI's proposed revisions scheduled for fiscal year 2026:

Product Category	Current Price Cap (JPY per ΔkW/30 min)		Proposed Price Cap (JPY per ΔkW/30 min)	
	Single Products	Composite Products	Single Products	Composite Products
Primary	19.51	19.51	7.21	
Secondary-1				
Secondary-2	7.21			
Tertiary-1				
Tertiary-2	N/A		N/A	

Under the current regime, METI's framework recognized that Primary, Secondary-1, and composite products impose higher technical burdens than Secondary-2 or Tertiary products. Consequently, these "fast" products have enjoyed a higher price cap of 19.51 JPY per ΔkW/30min, while Secondary-2 and Tertiary-1 products are capped at a lower price cap of JPY 7.21 per ΔkW/30min. Tertiary-2 products, procured on a day-ahead basis, have no mandated price ceiling, though procurement volume reductions and competitive dynamics have moderated prices.

If the proposed change is implemented in fiscal year 2026, the price cap for these premium balancing products would be reduced to JPY 7.21 per ΔkW/30min, which may harmonize price caps across all products except Tertiary-2, eliminating the differential treatment currently afforded to faster-responding reserves. Regulators have not proposed a price cap with respect to Tertiary-2 products, as the risk of unnecessary cost increases is considered low.

The rationale METI articulated in its proposal centers on preventing excessive procurement costs. The METI proposal indicates that METI has been concerned that bids settled near the current JPY 19.51 cap were increasing total settlement costs. The cap revision is intended to promote more efficient bidding behavior while maintaining stable procurement of required balancing capacity.

Implications for the BESS Market in Japan

Revenue Impact on BESS Project Economics

The proposed price cap reduction may pose a challenge to BESS project economics in Japan, to the extent projects' economic viability depends on a premium in the fast-response balancing market. During fiscal year 2024, BESS assets participating in the balancing market achieved average settlement prices above the proposed JPY 7.21 threshold, particularly for composite products where BESS resources settled at an average of JPY 15.70 per ΔkW/30mins (derived from ~31.39 JPY per ΔkW/h) compared to JPY 5.77 across all resource types. Even after procurement volume reductions implemented mid-year, BESS units continued settling at an average of JPY 10.84 per ΔkW/30mins (derived from ~21.68 JPY per ΔkW/h) in April 2025. Please note that these figures represent the average pricing; the scarcity peaks were higher, sometimes hitting the JPY 19.51 per ΔkW/30mins cap. The proposed cap would effectively lower the hard ceiling on revenue upside from the fast-response balancing market, removing much of the scarcity premium that BESS assets sometimes rely on to offset degradation costs and maintain economic viability.

This revenue compression arrives at a sensitive juncture for Japan's BESS sector. OCCTO has awarded over 1.37 GW of power capacity and more than 6.7 GWh of energy capacity through its Long-Term Decarbonization Power Source Auction as of 2024, with a national target to install 10 GW of energy storage capacity by 2030. Multiple developers have announced BESS projects predicated on revenue assumptions that relied on balancing market participation at higher price points. For these projects and other future projects that might rely on similar assumptions, economic feasibility may need to be reassessed, with potentially less reliance on fast response balancing market arbitrage as a primary revenue source.

Altered Market Participation Dynamics

We would also note that the price cap reduction may alter participation incentives in Japan's balancing market. Industry participants at the METI's System Review Working Group meetings in October and in December showed concerns that the lower caps may discourage market participation, particularly when spot market prices or marginal costs exceed JPY 7.21. This may create a realistic scenario where withholding capacity from the balancing market becomes economically rational, potentially exacerbating shortages in times where BESS discharge would otherwise be available to alleviate excess demand. Conversely, the changes would appear to be encouraging BESS developers and operators to reorient their participation strategies toward providing services outside the balancing market, including in the long-term capacity market (via the LTDA or otherwise) and/or via corporate power purchase agreements.

Further Regulatory Updates

The price-cap revisions contemplated in the Oct. 29, 2025, METI proposal remain a draft proposal and have not yet entered the formal rulemaking process. For the METI proposal to become final, METI must first internally finalize its proposal and submit it for a public comment period (typically 30 days, in accordance with the requirements of the Administrative Procedure Act). Thereafter, METI will review feedback and issue a final regulatory notice approved by METI and other relevant cabinet ministries.

Historically, METI proposals have generally been adopted without significant modification once they reach this stage. However, the METI's System Review Working Group meetings in October and December 2025 revealed opposition from market participants, who questioned both the necessity and prudence of the proposed reductions as well and voiced the view that further discussion would be needed due to the significant impact on the market. We may see METI further consider its cost containment objectives against the risk that its revised regulatory framework may chill investment appetite in BESS and the wider renewables sector.

Developers and investors may wish to monitor several specific regulatory developments in the coming months. First, whether METI proceeds with the April 2026 implementation timeline or delays pending further consultation. Second, whether any transitional arrangements or grandfathering provisions may apply to projects that have already secured financing or reached advanced development stages. Third, how the proposed caps interact with METI's planned transition to mandatory market participation requirements and the eventual simultaneous market structure. Lastly, when and how the proposed caps, if implemented, are revised given METI's note in the METI proposal that the caps would be reviewed as appropriate to ensure that they remain at a suitable level given the prevailing circumstances at that time. Each of these elements may affect the risk-adjusted returns available from BESS investments in Japan. Any transitional arrangements or grandfathering regime may affect the extent to which current market participants need to re-examine their financial modelling and/or contractual documentation, to align with

the current regulatory regime and any resulting retroactive changes to projects' economics resulting from the changes.

LTDA Implications

Market participants should also consider the proposed price cap reductions in the balancing market alongside OCCTO's recently proposed changes to the LTDA Guidelines for the 2025-26 auction round. For the LTDA 2025–26 auction round, OCCTO has indicated that the procurement allocation for pumped hydro and BESS combined projects will be limited to only 800MW. Further, the draft LTDA Guidelines published on Aug. 27, 2025, states that BESS systems would be required to meet a minimum six-hour continuous operation requirement.

These revisions, when taken together with the proposed changes to the balancing market price caps regime, may indicate a trend toward METI/OCCTO de-emphasizing fast reserve arbitrage BESS systems, and promoting the adoption of a more limited volume of long-duration BESS, providing stable long-term supply in the capacity market. Longer-term capacity-like revenue payments (via the LTDA or via a corporate PPA) may become a higher priority as anchor revenue in the revenue stack for BESS projects going forward. There appears to be an implicit push towards low C-rate systems (0.25C–.5C) supporting longer multi-hour discharge, in lieu of higher C-rate systems that perform best for short-term arbitrage. All relevant stakeholders may wish to factor this trend into their decision-making and modeling analysis in the consideration of potential BESS project investment.

Conclusion

Market participants should closely monitor the final adoption of the METI proposed balancing market price cap reductions during the remainder of the fiscal year, particularly as developers prepare to potentially participate in the 2025–26 LTDA. The proposed cap reductions for the fast-response balancing market, together with modifications to the LTDA guidelines, may indicate a shift in policy regarding the promotion of BESS in Japan, and may have a significant impact on potential BESS projects' revenue stack and overall economic viability. Market participants should remain fully aware of the evolution of such policies going forward and consider their impact on existing and prospective BESS projects.

Authors

This GT Alert was prepared by:

- Joseph Kim ∞ | +65 6964 0602| Joseph.Kim@gtlaw.com
- Yuko Ino | +81 (0) 3.4510.2211 | Yuko.Ino@gtlaw.com
- Jared Raleigh | +65 6964 0603 | Jared.Raleigh@gtlaw.com
- Kazuo Kasai | +81 (0) 3.4510.2262 | Kazuo.Kasai@gtlaw.com
- Daniel Senger | +81 (0) 3.4510.2241 | Daniel.Senger@gtlaw.com

∞ As a Foreign Legal Consultant Office, the practice in Seoul is limited to legal advice regarding U.S. law, treaties with the U.S., and universally recognized customary international law. We may not render legal advice on Korean law matters.

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˘ Not admitted to the practice of law.

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