

Client Alert

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China's New Environmental Protection Law Implications for Overseas Investors, Joint Ventures and Trading Partners

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INTRODUCTION

On January 1, 2015, China will formally begin implementing an updated Environmental Protection Law ("the China EPL"). First promulgated in 1989, this is the first time China's fundamental environmental protection statute has been revised, and, in many ways, it reflects how far China has come in its environmental awareness from 25 years ago. After sacrificing environmental quality in exchange for economic development for the past 30 years, the national government in China is now stating that environmental protection considerations must be incorporated with socioeconomic development plans and that environmental awareness and socioeconomic development will be measured in tandem.

To achieve the national government's goals, the updated China EPL includes many important additions and revisions, the most significant of which include (1) heightened consequences for violating China's environmental laws, (2) expanding the scope of projects subjected to environmental impact assessment requirements, and (3) allowing nongovernmental organizations to take legal action against polluters on behalf of the public interest.

This article seeks to highlight a number of key additions and updates to the China EPL and assess how they are likely to affect local businesses, state-owned enterprises (SOEs), and multinational corporations (MNCs).

KEY ADDITIONS AND UPDATES TO THE LAW

The updated China EPL imposes significantly greater controls and responsibilities on corporations and local government bodies, while also giving China's environmental regulators and enforcers more "teeth" to incentivize and demand compliance. The five most significant developments included in the new EPL in relation to businesses are as follows:

1. Increased accountability of polluters

A significant reason why China's 1989 EPL had not been effective is a matter of basic economics - it often cost a business more to abide by the law than to pay a fine for violating it. For example, a certain large electricity generator complex in China was reported to have faced spending between RMB 500,000 and 600,000 to control its pollution output. However, when its factory was shut down after failing to comply with the law, it had to pay only a one-time fine of RMB 10,000. To avoid a perpetuation of this situation, Article 59 of the updated China EPL will introduce daily, accumulating fines that will begin to accrue on the day after the date of the ordered correction.

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Aside from imposing more meaningful fines, the updated China EPL also makes it more difficult for companies to break the law in the first place by, under Article 56 requiring them to publicly disclose their environmental impact assessment (EIA) documents and solicit public opinion to a much greater extent than required under the 1989 version of the law. Consequently, it may soon become more difficult for businesses to construct new projects that could damage the environment unless they can justify their decisions to *both* the local government and the public.

Lastly, under Articles 53, 62, and 63 of the updated China EPL, transparency will be increased significantly - any violations by polluters may be made public and could damage their reputations domestically and abroad. Individuals who were directly in charge and/or other personnel who failed to abide by updated environmental requirements will not be able to hide behind the corporate walls and reputations of their companies and may also face detention of up to 15 days.

2. Increased accountability of government bodies/officials

Government bodies and officials responsible for keeping polluters in check also have increased accountability under China's new EPL. Under the current environmental protection regime, while enterprises that do not comply with environmental regulations are subject to penalties, these are often reduced or waived due to a proliferation of mutually beneficial relationships between regulated businesses and relevant government departments. To tackle corruption, government officials will now, under Article 68 of the new EPL, be subject to much heavier penalties (such as demotions, dismissals, and criminal prosecution) for committing unlawful acts, such as for improperly granting permits and approving EIA documents, covering up violations, and failing to issue orders to suspend operations for polluters. Furthermore, whereas opportunities to advance in the governmental hierarchy used to mean meeting only economic targets to fuel China's breakneck modernization, performance evaluations will soon take environmental protection targets into account. Under Article 26 of China's new EPL, officials at or above the county level will be appraised on their environmental as well as economic performance, and their evaluation results will be made public.

3. Increased public disclosure

Articles 53 and 54 of China's new EPL require publicizing information regarding environmental monitoring, environmental quality, and the collection and use of pollutant discharge fees. Additionally, under Article 55, designated types of heavy polluters must disclose more specific environmental information, including the names of the main pollutants discharged, their concentration and emission levels, and information on the construction and operation of their pollution prevention and control facilities. These new disclosure requirements will not only expose enterprises to much higher levels of public and governmental scrutiny but could also expose them to civil lawsuits, as discussed below..

4. Public interest lawsuits

Under China's 1989 EPL, it was difficult, if not impossible, for environmental protection groups or individuals to bring lawsuits against polluters because no aspect of the law stated one could sue for environmental degradation. The new China EPL partially addresses this deficiency with Article 58, which allows NGOs to file claims in the

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People's Court as long as the NGO (1) is registered with the civil affairs department at or above the municipal level and (2) has been focused on environment-related public interest activities for five consecutive years or more.

While this aspect of the new law may still prove significant, its impact may be limited for three reasons. First, it has been estimated that there are currently only about 300 NGOs in China that could meet these two requirements. Second, the fact that individuals still cannot bring their own lawsuits could reduce the potential number of polluters that may be brought to justice. Third, and perhaps most significantly, it is still not possible for NGOs to file lawsuits against the authorities if those authorities fail to properly enforce the law.

5. Protection for whistleblowers

While it does not go as far as may be desirable in terms of the ability to bring lawsuits, to encourage public involvement in monitoring corporations and regulatory officials to make sure they carry out their duties lawfully and appropriately, the updated China EPL does at least protect any citizen or organization that reports (1) environmental pollution or ecological damage caused by any institution or (2) any failure by an environmental regulatory body to perform its legal duties. More specifically, under Article 57, any such report and the information of the whistleblower must be kept confidential.

PRACTICAL IMPLICATIONS FOR ENTERPRISES

The fundamental message that the updated China EPL sends to corporations and regulatory bodies is clear - China is now quite serious about improving environmental quality. In this regard, the Chinese government is also offering carrots to go along with the proverbial stick. For example, Article 21 of the new EPL provides that enterprises that comply with the new environmental protection regime, or that are active in the industries related to environmental technology, will be awarded tax breaks and fiscal assistance to further encourage reducing the emission of pollutants.

The financial incentives in the updated China EPL are not merely rooted in the goals of saving the environment and improving citizens' health. They are also designed to significantly bolster China's efforts to build up its strategic industries outlined within its 12th Five-Year Plan. According to the Plan, the industries of energy saving and environmental protection, new energy, and new energy vehicles, among others, are to account for 8% of China's GDP by 2015.

Hence, keeping Chinese companies in key industries accountable and holding them up to higher environmental standards is actually an important strategic component of China's overall economic strategy. Therefore, the national government has already been preparing to step up enforcement of its environmental law. For example, in 2006 the Ministry of Environmental Protection (MEP) set up branches in 11 cities that are independent from local government interference to monitor environmental issues. In 2008, the MEP was also "promoted" from a subordinate organ of the State Council to a component of the State Council.

MEP has since set up an empowered environment-monitoring bureau. The effect has been that local governments have become more reluctant to look past a local firm's environmental activities for reasons relating to economic growth.

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IMPLICATIONS FOR OVERSEAS INVESTORS, JOINT VENTURES, AND TRADING PARTNERS

MNCs that have offices in China, rely on Chinese suppliers, and/or trade with China will be affected by the updated EPL and, in the near term, may face some uncertainty from its initial implementation. To best position themselves, MNCs should consider doing the following:

1. Align corporate strategy with government signals

As China's national government obviously plays a very active and powerful role in allocating resources and determining economic policy, it is imperative for businesses, including MNCs, to focus on areas that the government has indicated are important. While this might sound obvious, it suggests that companies should not just abide by, but also anticipate, the implications of this policy change and embrace environmental innovation.

For example, engine manufacturer Weichai Power developed and produced a "Blue Engine" line in 2005, the first 10- and 12-liter high-power engines based on the European Union (EU) III emission standard. China only introduced the national III standard in 2009, but Weichai was already manufacturing EU V products in same year. In anticipating and going above and beyond the government's expectations, Weichai not only won various awards and a stellar reputation but also reaped an increase in market share and profits: by 2009, the firm had more than 40% of the Chinese market for trucks over 15 tons, more than 80% of carriers used its engines, and it became a serious competitor to Cummins and other large engine manufacturers.

To encourage more companies to do the same, the new China EPL rewards enterprises that "achieve further pollution reduction beyond statutory standards" by providing financial assistance, awards, and benefits (Article 22). Other ways MNCs can align themselves with the Chinese national government's message is to take on environmentally conscious projects in China and promote the company's environmental awareness to the Chinese public and international audiences via websites and CSR reports.

2. Address Strategic Alignment

As discussed above, the merging of environmental policies and actual structural changes in the Chinese government and legal system that will allow these policies to be implemented is now taking shape. As this has not previously been the case in China, it likely will create more uncertainty and some potentially higher costs in the short term. While it will undoubtedly take time to see whether the updated China EPL is implemented effectively, it is advisable in the near term for MNCs and other firms to "play it safe" by avoiding "regulatory shopping" and instead aiming to integrate local and global environmental standards.

Both MNCs and local enterprises have historically taken advantage of China's regional competition and fragmented bureaucracy to "shop around" for lower environmental standards so as to reduce costs. However, if the elevation of the MEP and adoption of the new EPL are any indication, "regulatory shopping" is going to become increasingly difficult and risky in China, especially since there are going to be significant financial and even criminal costs to seeking out such short-term benefits. Over the past several decades, the MNCs' capitalization on China's loosely enforced environmental and health and safety laws has cultivated distrust and grievances. Now, as China increasingly shifts from a low-cost supply chain producer to an immense consumer market itself, the old strategies are increasingly falling out of favor.

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3. Prepare for Transparency and Monitoring

Generally, Chinese companies and MNCs alike have not historically disclosed much information regarding their environmental performance in China, both because of the lack of effective monitoring and because the relative unawareness of the Chinese populace regarding environmental protection meant there were few if any incentives or benefits for companies to do so. However, as environmental issues have become an increasingly prominent social problem and scandals spread like wildfire due to proliferation of the Internet, governments, MNCs, and domestic firms have all felt increasing pressure to be more transparent and open themselves up for monitoring.

In fact, Western MNCs in particular are now expected to lead the way in establishing more open transparency norms given their know-how and experience when operating in stricter jurisdictions. Much like aligning corporate strategy with government signals, MNCs in China should consider promoting higher standards of transparency and environmental advocacy via websites, CSR reports, and annual environmental reports. They are also particularly well advised to set up mechanisms for managing public relations and transparency issues in cases of emergency (e.g., setting up an environment risk management team).

LOOKING FORWARD

Since the announcement of the adoption of the new China EPL earlier this year, the Chinese government has continued to take steps to gear up for its implementation, which will formally begin in January 2015. In June 2014, the country established an Environmental and Resources Tribunal of the Supreme People's Court, the highest court in mainland China. Its purpose is to provide "unified guidance and coordination" to the 134 specialist environmental courts set up by local governments and is a clear attempt to increase enforcement-related direction from the national government so polluters and officials can be held more accountable.

There can be no mistaking that the general direction adopted by the national government in China is to improve China's environment meaningfully and strategically. While we cannot be sure how successful any particular aspect of the new law's implementation will be at this point, companies are advised not to just take a "wait and see" approach to determine which policies will be implemented more effectively and which may not be. This is a risky tactic - guessing wrong could make the company the target of enforcement action, result in significant penalties, and damage the reputation of the company both in and outside of China. Instead, the economically and socially sound decision is to adjust corporate strategy in the nearer term to match that of the national Chinese government's very strong signals and, perhaps, to aim to not only meet but exceed the environmental standards and requirements being put into place. If companies seize this window of opportunity to distinguish themselves from other firms, the potential positive payoffs are likely to be significant in the longer run.

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