



Issues of enforcement continue to plague China's efforts to implement environmental policies. Sarah Stokoe and Stéphane Gasne of Gide Loyrette Nouel bring us an overview of efforts made to regulate and administer the requirements of environmental legislation in the PRC.

# China's environmental law framework

## Environmental Policy and its Enforcement

### The basis of environmental policy administration and enforcement

On a political level, PRC environmental planning and policies are primarily shaped and determined by the Five-Year Social and Economic Development Plans, which are elaborated by the Chinese Communist Party and government and approved by the National People's Congress. These Five-Year Plans (FYPs) are supplemented by more specific Five-Year Environment Plans (FYEPs), which are further broken down into five-year sectoral plans in areas such as water management of key rivers and lakes, hazardous waste management or the reduction of air pollution in designated zones.

China's highest state body and only legislative house, the National People's Congress (NPC), enacts statutory environmental laws, which governments at different levels are in charge of enforcing. The State Environmental Protection Administration (SEPA), often quoted as the PRC's 'environmental watchdog' is responsible for overall supervision and administration of environmental protection work. Although SEPA's status has changed a number of times over the years, it has very recently been upgraded to ministry level and will serve as the new Ministry of Environmental Protection.

The actual implementation of environmental policies at the sub-national level is vested in the local Environmental Protection Bureaus (EPBs), which are in charge of monitoring industrial pollution discharge, site inspections, issuing discharge fees/fines and prosecution, *inter alia*.

### Enforcement agency issues

Although China boasts a wide range of reasonably sophisticated environmental laws and regulations, their enforcement is far from efficient and unified, and it is generally felt that enforcement agencies fail to fully perform their mandate. Inconsistencies in enforcement are mainly due to: (1) a lack of coherence between regulations; (2) structural deficiencies in the environmental management system; and (3) the general policy framework which favours economic development over environmental concerns.

Recently, the government acknowledged that environmental compliance and enforcement in China has serious shortcomings and the 11th FYP (2006-2010) marks a policy shift from a narrow approach purely based on GDP to a more sustainable economic development model. In this

regard, the recently revised *Water Pollution Prevention and Control Law* is a step forward in initiating this change, as it lays the foundation for a national-level assessment mechanism for water protection, and water protection projects will be accounted for in the evaluation of local governments and their officials' performances.

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Enforcement of environmental laws through prosecution is scant: according to unofficial estimates in 60 percent to 70 percent of pollution cases victims are not successful in court.

### Disclosure requirements of public authorities

In 2007 SEPA adopted the Trial Measures on the Disclosure of Environmental-Related Information. These measures provide that citizens and private companies are entitled to request environmental related information from public authorities, which in turn must make such information available within a set time-frame. The scope of disclosure is broad and includes environmental planning, statistics, discharge levels of major pollutants, as well as the type, volume and disposal of solid waste produced in medium to large cities. Public authorities are also required to adopt environmental emergency plans and disseminate information on administrative procedures. Interestingly, they must also publish and update a list of companies whose emission of pollutants exceeds the national or local emission

standards or which refuse to comply with injunctions or pay penalties for environmental wrongdoings.

The obligation to publicly disclose environmental-related information is reciprocally required from companies as regards excess discharges and information on the construction and operation of pollution treatment facilities and equipment.

### Environmental Permits

#### Requirements and transferability

All plants/facilities that directly or indirectly discharge hazardous or controlled substances are subject to the Discharge Permit System. Under this permit system, all discharging entities must declare and register any emission of pollutants with the local EPB shortly after the facility acceptance and any start of operations. The registration form includes quantity and regularity of emissions, as well as their concentration - and such information is to be regularly updated. The competent EPB then issues a permit with precise indications of discharge limits of pollutants in an enterprise's wastewater/solid discharge and air emissions. Discharge fees vary according to the type of pollutant, although rebates are possible where reductions have been verified and sometimes postponed in practice.

Other types of environmental permits may have to be obtained. The disposal of radioactive waste, for instance, is subject to specific authorisation granted directly by SEPA, and an operating licence issued by the EPB (at county level or above) is necessary for the collection, storage, and disposal of solid hazardous waste. As a general principle under Chinese law, discharge permits are location-specific and are granted *intuitu personae*, i.e. not transferable.

If an applicant is denied a discharge permit, he may file a claim before the administrative division of the People's District Court within three months of the EPB's refusal. The unsuccessful applicant may file for reconsideration within seven days. The EPB then has ten days to issue a final notice. If such second notice is still not positive, the applicant may file a claim before the People's District Court within fifteen days.



### Environmental audits and impact assessments for particularly polluting industries

China was one of the first developing countries to introduce environmental impact assessment (EIA) requirements for new construction or expansion projects. A trial statute was enacted and later followed by a piece of cornerstone legislation: the EIA Law, which came into force on September 1, 2003.

Any company that initiates construction works without having first secured EIA approval may be ordered to cease works immediately and/or pay fines. In some provinces, fines may be a percentage of the total investment amount of the project as a whole. In addition, another consequence of non-compliance with EIA Law

provision is potentially restricted access to credit as a green credit policy was jointly adopted by SEPA, the Bank of China and the China Banking Regulatory Commission (CBRC).

#### Enforcement powers of environmental regulators

Chinese environmental regulators enforce regulations through administrative sanctions and their powers of prosecution. SEPA and local EPB may issue warnings, injunctions, fines (with

escalation of fees in case of a persisting breach), and confiscate illegal gains. In serious cases, they may suspend or shut down plant operations and revoke the permit/licence.

In reality, administrative penalties are not severe enough to ensure environmental compliance. For example, the maximum fine for the most serious case of air pollution is RMB 500,000 (approximately US\$ 72,000), which might explain why the cost of an environmental breach is often considered less expensive than compliance itself. This issue has very recently been addressed for the first time with regards to water pollution, but remains a persistent issue for other types of pollution.

### Liabilities

#### Types of liabilities and typical defences

Breach of environmental laws or permits can give rise to civil and criminal liabilities, as well as to administrative fines. The Environmental Protection Law of 1989 significantly

provides for strict liability in cases of environmental pollution. Civil claims may be brought either before the relevant administration body or a People's court. The statutory limit for legal action is three years from the time when the victim became or should have become aware of the loss, which differs from the general two year limit for civil actions.

According to the EPL, the Criminal Law (1997) and the Supreme People's Court's Interpretation on Criminal Cases Involving Environmental Pollution (2006), criminal liability may arise when major pollution accidents cause injuries and/or significant losses of public or private property. Sanctions range from fines to imprisonment for up to ten years.

With regards to possible defences, the EPL and a number of anti-pollution laws and regulations provide that no liability shall be incurred when the pollution results solely from 'natural disasters' (i.e. *force majeure*). It is also generally the case that liability may be limited or excluded when the victim itself or a third party is at fault, which is in line with the General Principles of Civil Law (1986).

An operator is generally liable under the regulation on which a pollution permit is based if it causes environmental damage above or beyond the scope prescribed by such permit. However, the fact an operator pollutes within the permit boundaries does not prevent the competent Chinese authority from fining the operator under another applicable regulation which was not abided by nor does it prevent a Chinese judge from holding the operator liable for a damage to third parties under civil or criminal law.

#### Directors and officers of corporations

The managers or other officers or employees of Chinese companies may be held personally liable, either solely or jointly with the company, for acts performed on



behalf of the company in the course of their functions. According to the *General Principles of Civil Law* and the *Company Law*, personal liability shall be applied in cases of serious wrongdoings or conducts characterising illegal activities, and many laws and regulations of the PRC dealing with the duties and obligations of organisations apply the responsibility for their actions to the 'person in charge'. For instance, Article 38 of the EPL provides that in serious cases of environmental pollution, the person in charge shall be subject to administrative liability.

## The level of compliance by enterprises with pollution standards and permits is checked by EPB inspectors who carry out regular inspections, and sometimes surprise site visits, without a warrant

Applicable managerial liability insurance policies generally cover personal injuries and damages to property caused to third parties by environmental accidents, but the person in charge shall not obtain an insurance coverage if their acts constitute illegal behaviour or wilful misconduct.

Managers and other officers in charge of the company's business may subscribe to third-party claims insurance policies covering claims for personal injury or damage to property caused by environmental pollution. Under such policies, exemptions are generally applicable in the case of illegal behaviour or wilful misconduct.

### Regulators

#### Powers of Regulators

The level of compliance by enterprises with pollution standards and permits is checked by EPB inspectors who carry out regular inspections, and sometimes surprise site visits, without a warrant. Environmental regulators benefit from very broad information-gathering powers, and may require the production of documents

(including technology and trade secret materials, to the extent necessary for compliance verifications), demand samples and interview employees.

### Reporting Obligations

#### Disclosure

In practice, reporting duties are contained in discharge permits or licences, which usually require the operator to supply the EPB with data on emissions/discharges on a regular basis and to inform the EPB of any accident without delay.

Under PRC law, there is no specific offence of omission to disclose such events, as the various environmental statutes merely provide that corporate entities or individuals have the right - not the obligation - to report pollution caused by medical/solid waste or atmospheric pollution, with the exception of the case of marine pollution. Indeed, any unit or individual that has caused or may cause marine pollution must immediately report the accident to the competent authority relevant State Administrative Department empowered to conduct marine environment supervision and control.

There is no statutory requirement that requires a seller to expressly disclose environmental issues in the context of a merger or takeover transaction. Instead, environmental issues are dealt with in contractual terms and representations and warranties are usually required from the shareholders of the target company which may include environmental matters.

#### Contaminated land

There is no mandatory legal requirement to investigate land for contamination, and soil and groundwater contamination reports are required only by a SEPA Circular (supplemented by local regulations) upon decommissioning of a site or prior to a change of activity at a site where hazardous wastes are handled or generated.

Although investigation for land contamination is not a positive obligation per se under the EIA Law, environmental impact reports for construction projects must incorporate an analysis of the groundwater and land properties of the area surrounding the project, which may incidentally identify soil contamination on the building site itself. Soil surveys and contamination remediation may also be a contractual condition for obtaining or transferring land use rights.



Illustration: Johnnie Au

### Emissions Trading and Climate Change

#### Schemes and operationalisation

The first Chinese emissions trading platform was set up on a trial-basis in Jiaying, Zhejiang Province, on November 10, 2007 under the local EPB's supervision.

Greenhouse gas (GHG) emission reductions in China largely take the form of emission reduction credits (CERs) certified under the Kyoto Protocol Clean Development Mechanism (CDM). The CDM arrangement allows industrialised and economy-in-transition parties to the Kyoto Protocol, referred to as Annex I Parties, to acquire CERs originating from GHG emission reduction projects based in non-Annex I Parties (including China) to comply with their emission reduction commitments.

The Measures for Operation and Management of Clean Development Mechanism Projects (2005) are the implementation legal framework for China, setting out the procedure to be followed for the approval of a CDM project at the national level and the allocation of revenues from the sale of CERs between the Chinese government and the project sponsor. If the CDM Executive Board confirms the final verification report on GHG emission reduction obtained from the local Designated Operational Entity and subsequently issues CERs, it is specified that between 2 percent (emissions reduction projects listed in the encouraged category) to 65 percent (Hydro-Fluoro-Carbon and Perfluorated Carbon emissions reductions projects) of the proceeds of sale of such CERs shall be remitted by the project owner to the Chinese government.

To date, while numerous CDM Projects have obtained approval from the National Development and

Reform Commission, which is the Chinese Designated National Authority, CERs have been issued by the CDM Executive Board for only a limited number of projects. Such CERs are mainly to be traded under the EU Emissions Trading Scheme.

### Some remaining considerations

#### Environmental indemnity to limit exposure

Although sellers generally require purchasers to rely solely on their own investigation of assets, they may agree on indemnification to a contractually stipulated extent, should environmental liability be incurred following the transfer of ownership of assets to which environmental contingencies may be attached. These agreements on the allocation of environmental liabilities relating to, for instance, contaminated land, are valid and enforceable.

#### Shareholder and parent company considerations

Pursuant to their limited liability status, Chinese companies shall be liable only on their assets, and shareholders are usually only liable up to the amount of capital they contributed. A shareholder may however become liable for the company's actions or omissions if (i) the company acted under a mandate contract on behalf of the shareholder, (ii) the shareholder intervened as 'person in charge' (for example as manager) in the breach of environmental law or commission of an environmental damage or (iii) the shareholder acted as guarantor of the company. In contrast, where the shareholder would actually be liable as agent, manager or guarantor, the shareholder may be held liable as shareholder if it is considered to have abused the independent status of corporate legal person and shareholders' limited liability in order to avoid debts and therefore damaged the interests of the company's creditors. Under such circumstances, the shareholder may be held jointly and severally liable for the company's debts, in accordance with Article 20 of the *Company Law* (2005).

Whether the parent company of a Chinese foreign-invested enterprise may be tried in its jurisdiction for pollution committed in China by a subsidiary depends on the conflict of law provisions applicable in the parent company jurisdiction.

#### Whistle-blowers

There is no generally applicable law or regulation pro-

tecting whistle-blowers in China. However, Article 6 of the EPL, according to which all individuals are obliged to protect the environment and have the right to report on pollution events and acts damaging the environment, may be used as a defence in the case of litigation for breach of a confidentiality undertaking by an employee of a polluting enterprise.

#### Class actions

The *Civil Procedure Law* (2007) sets out the possibility for several parties with the same or a similar cause of action to have their cases tried jointly. The competent court may issue a public notice stating the particulars of the case and claims and may request that any interested claimant registers with the court within a certain period of time. Following this procedure, the judgment or ruling shall apply to all claimants who have registered within the set period. These provisions on joint actions have already been applied in cases of environmental pollution and the *Water Pollution Prevention and Control Law* has recently introduced a specific joint action for victims of water pollution.

Damages are set by professional judges in order to reflect reasonable compensation and generally do not include a punitive element.

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