

## Environmental Protection is Enshrined as Official Ideology in China Amid Major Reforms

***President Xi announces a comprehensive, 14-point reform policy that has long-term implications for companies with business interests in China.***

### **Key Points:**

- President Xi Jinping has formalized a national commitment to the strengthening of environmental protections in China
- Aggressive environmental enforcement actions and the development of new permitting rules and a national emissions trading scheme are a few of the recent indications of the country's changing environmental priorities and policies.

### **President Xi Announces a “New Era”**

Chinese President Xi Jinping delivered a speech at the 19<sup>th</sup> National Congress of the Chinese Communist Party (CPC) announcing the arrival of a “new era.” The speech, given on October 18, set forth a 14-point policy program that the Communist Party promptly enshrined in its constitution as “Xi Jinping Thought on Socialism with Chinese Characteristics for a New Era” (more commonly referred to as “Xi Jinping Thought”).<sup>1</sup> The 14 points included President Xi's clear and specific call for environmental protection to build a “Beautiful China”:

*“We must establish and practice the philosophy that lucid waters and lush mountains are invaluable assets, uphold the basic national policy for energy conservation and environmental protection, treat the ecological environment as we treat life, coordinate the systematic management of mountains, waters, forests, fields, lakes, and prairies ... build a beautiful China, create a good production and living environment for the people, and contribute to global ecological safety.”<sup>2</sup>*

Another of the 14 points focuses on “new development concepts”, which must be both “scientific” and “green.”<sup>3</sup>

This addition to the CPC's constitution is a major political development in China. Only two other leaders' ideologies have been specifically incorporated by reference into the CPC constitution: those of Mao Zedong, founder of the People's Republic, and Deng Xiaoping, who initiated the “reform and opening” movement that resulted in China's economic boom during the last 30 years. However, the addition of “Deng Xiaoping Theory” to the constitution occurred only after Deng's death, while the CPC has added “Xi Jinping Thought” during the President's term in office. In addition, it is notable that President Xi's

philosophy has been labelled “Thought,” the same description attached to Chairman Mao’s philosophy, prompting positive comparisons between President Xi and Chairman Mao — who continues to hold an exalted status in China.

The National Congress of the CPC, which takes place every five years in October or November, is often a platform for announcing major policy shifts as new members join the Standing Committee of the Politburo, the CPC’s top-level leadership. The 19<sup>th</sup> National Congress marked the beginning of President Xi’s second five-year term as the President of China and Secretary General of the Communist Party. In a break with tradition, the CPC did not announce a successor to President Xi, suggesting that Xi’s influence could last farther beyond 2023 (when his term ends).

From an environmental perspective, the Communist Party’s official adoption of Xi Jinping Thought formalizes a fundamental shift in environmental policy. China has in recent months been approaching environmental improvement as a development goal on par with economic growth (rather than as a secondary objective). China’s GDP growth target of 6.5% for 2017 reflects this shift (in the past, China consistently targeted double-digit growth).<sup>4</sup>

Moreover, the CPC announced Mr. Xi’s “new era” on the heels of one of the largest environmental crackdowns in China’s history, in which more than 80,000 factories have been assessed with environmental violations.<sup>5</sup> Regulators have disciplined more than 12,000 government officials for failing to properly enforce environmental regulations.<sup>6</sup> The fact that government officials have been targeted in the crackdown reflects President Xi’s ongoing commitment to pursue both “tigers and flies” (high-ranking officials and local civil servants) in a campaign that has resulted in more than 100,000 indictments in an effort to ensure effective environmental regulatory enforcement.<sup>7</sup> The government clearly views both the battling of environmental issues and corruption as an essential component of “social harmony” contributing to a “beautiful China.” These enforcement trends are becoming a norm in the evolving political system known as “Socialism with Chinese Characteristics.”

## **Environmental Reform Likely to Continue Despite Economic Fallout**

Current developments with respect to China’s environmental priorities and policies are rooted in reforms that began in 2014 when the country revised and strengthened its Environmental Protection Law (EPL).<sup>8</sup> The EPL — which functions as a framework and an enabling statute for other environmental legislation — states that the government holds responsibility for monitoring environmental quality, providing environmental services, and enforcing environmental law. Since the amended law became effective January 1, 2015, China’s Ministry of Environmental Protection (MEP) and other agencies have worked to implement its provisions. These provisions, *inter alia*, adopt tax, pricing, and government procurement policies:

- Encouraging enterprises to reduce pollutant discharges<sup>9</sup>
- Requiring the government to support the conversion, relocation, and shutdown of operations to protect the environment<sup>10</sup>
- Granting authority to local environmental protection agencies to shut down and seize facilities and equipment causing pollutant discharges<sup>11</sup>
- Committing to improved and enhanced protection of investigation, monitoring, assessment, and recovery systems for air, water, and soil<sup>12</sup>

As a result, China's environmental law enforcement paradigm has shifted significantly since 2015, which has affected several regional economies. Many multinational companies have observed significant price hikes from Chinese suppliers, due to regulators shutting down factories (sometimes for months at a time) as part of the recent pollution crackdown.<sup>13</sup> The government has also adopted measures to reduce China's reliance on coal and has increased investment in renewable energies.<sup>14</sup> For example, in February 2016, the government announced that planned coal industry cutbacks could cause as many as 1.3 million coal workers to lose their jobs.<sup>15</sup> China has publically committed to lowering carbon dioxide emissions and increasing the share of non-fossil fuels in primary energy consumption by 2030.<sup>16</sup> Each of these measures, as well as other initiatives aimed to tackle air, water, and soil pollution, directly affects business in China. Notwithstanding the economic impact of ecological reform, however, President Xi has signaled resolute commitment to reversing the environmental and public health issues plaguing the nation.<sup>17</sup> To implement his vision, the Chinese government has recently announced or began to implement several key environmental initiatives and programs — the most significant of which are discussed below.

### **Amplification of Environmental Impact Assessments (EIAs)**

The government is amplifying efforts related to the review and approval of large-scale planned projects, with a renewed emphasis on continuous monitoring.<sup>18</sup> Several types of activities are subject to EIA requirements in China. The State Council reviews and approves all new and amended construction projects that cross the borders of provinces and other special construction projects (generally large-scale construction and energy projects). Beyond this, the provinces, autonomous regions, and municipalities directly under the Central Government (direct-controlled municipalities) set the scope of authority for examination and approval of EIA documents for construction projects. The requirements of each direct-controlled municipality are similar.

Historically, China has required governmental zoning plan and construction project sponsors to conduct an EIA — which serves as something like a license — prior to beginning construction. The relevant permitting bureau would review and approve a project design, require a project owner to build in conformance with the approval, and often, perform a “trial run” ensuring environmental compliance prior to operation. The EIA served as a prerequisite for other approvals and permits; in fact, if a developer attempted to build projects without submitting an EIA, he or she faced prescribed penalties.

The new rules generally maintain this process, but implement a few important changes. First, the rules re-delegate responsibility for EIA completion and review from local environmental agencies to project operators, and require the operator to publicly disclose EIA documents and generally improve public participation in major project planning. Importantly, the rules still impose high penalties on operators should they fail to conduct an appropriate compliance review. Moreover, in certain industries, completed projects also need to undergo a post-effect EIA process three to five years after commencing full operation. As a result, operators are more likely to promptly address and, as necessary, continuously monitor and remediate ongoing negative impacts of planned construction projects. Most importantly, President Xi's renewed interest in intentional enforcement of environmental regulations is likely to generate increased State Council and local authority attention in the EIA process.<sup>19</sup>

### **Nationwide Pollutant Discharge Permitting System**

On November 10, 2016, the General Office of the State Council released a national Implementation Plan for the Licensing System to Control Pollutant Emission (the Plan).<sup>20</sup> Prior to the Plan, pollutant discharge permitting rules existed only in some provinces and cities and the conditions for obtaining a permit varied among localities. The Plan enacts China's first national and comprehensive pollutant emission permits system.<sup>21</sup>

Pursuant to the Plan's new rules, China is implementing a unified permitting system. The system will require each entity that is discharging pollutants to obtain a discharge permit specifying the limits on the various types of pollutants permitted for discharge into the environment. If an enterprise is discharging multiple pollutants, the emission behavior and management of all those pollutants will be documented in the single permit covering both air and water emissions. The permit holder will also be subject to an ongoing obligation to periodically monitor its own emissions, and keep records of the category, concentration, and total discharge volume of pollutants emitted by its facility. Under the Plan, emitters will disclose pollutant data submitted on a public-facing permitting management information platform, along with enforcement information provided by the environmental protection authorities and a list of emitters discharging pollutants inconsistent with their permits.<sup>22</sup>

Plan implementation began immediately for thermal power plants and paper mills, which were required to obtain permits by the end of 2016. The Plan calls for 15 other industries to conform to its guidelines by the end of 2017, and all stationary sources of air or water pollution must be covered by 2020. Licenses will be valid for three years after issuance, and for five years after the first renewal. County and provincial-level environmental protection bureaus will issue the licenses according to MEP-established regulations and guidelines. The government will publicize information on issued licenses, applications, verification, and enforcement activities beginning in 2017.

The Plan advances the government's effort to enhance compliance enforcement and to encourage the public to engage in environmental stewardship and supervision — including by use of citizen suits. Notably, the monitoring data made available by the Plan may be used as a legal basis for enforcement action by environmental protection authorities and citizens. Indeed, the Plan requires permit holders to explicitly identify responsible persons and related employees that may be associated with discharges.

Companies reluctant to transition to this system (which will be mandatory by 2020) may be pacified by the fact that the Plan ties its permits directly to the emission trading scheme planned for rollout in the near term — a pollutant emission permit will serve as a certificate of emission rights.<sup>23</sup> Accordingly, permit holders may use the permit as evidence to trade reduced volume of pollutant emissions resulting from eliminating waste, employing cleaner production, pollution control methods, or upgrading technologies.

## **Rollout of Emissions Trading Scheme**

As previewed above, China is in the process of launching a national carbon emissions trading scheme (ETS), born of its commitments to reduce carbon emissions and fight climate change made under the Paris Agreement.<sup>24</sup> To prepare for the national ETS, China has been running pilots since 2013 in seven different regions of the country — including Beijing, Chongqing, Guangdong, Hunan, Shanghai, Shenzhen, and Tianjin.<sup>25</sup> Under the seven regional carbon exchanges, firms must buy permits to cover for emissions. The enterprises have used ETS as a platform to either sell redundant emissions allowances or to buy deficient ones, in order to fulfill their carbon reduction duty. Many political observers had expected China to announce the ETS' launch at the Bonn Climate Change Conference, which began on November 6, 2017; however, Xie Zhenhua, China's lead climate negotiator, indicated that the government had not yet approved the system, stating: "[p]reparations for the carbon market are basically complete and after approval it can go ahead."<sup>26</sup> As such, the ETS' implementation may not occur until late 2017 or early 2018.

China's ETS will be the largest national carbon emissions trading scheme in the world when it launches, covering as many as 10,000 enterprises in sectors such as steel, power generation, and papermaking.<sup>27</sup> The country's National Development and Reform Commission (NDRC) will provide oversight and coordination for the massive endeavor by establishing a national registry and trading platform for the

ETS.<sup>28</sup> While the scheme will invariably face tremendous logistical challenges, China's early successes in carefully developing the pilot systems signal that the country is determined and well-positioned to effectively implement the scheme on a national level.

### **Lender Liability Reform**

In April 2015, the Final Report of the People's Bank of China's Green Finance Task Force recommended imposing lender liability on banks to force financial institutions "to take environmental impact into consideration in making investment and financing decisions."<sup>29</sup> Such a change would render banks and other financial institutions liable for environmental pollution or damage that their borrowers cause. The new rule would have tremendous implications, especially if it lacked a due diligence "safe harbor" for entities like secured creditors.

Guidelines for establishing the green financial system released during the G20 Summit in September 2016 reaffirmed the nation's interest in incorporating lender liability for environmental damage into China's legal framework. The guidelines, published by the People's Bank of China and jointly issued with six other government agencies, received support from a range of Chinese government agencies — including the Ministry of Finance, the National Development and Reform Commission, and the Ministry of Environmental Protection, as well as China's regulatory commissions for banking, insurance, and securities. However, to date, no formal rules or regulations have implemented lender liability on the basis of environmental or health damages.

The introduction of lender liability without a mechanism for safe harbor would, of course, have far-reaching implications in one of the world's key manufacturing and financial markets. The new guidelines have attracted significant attention from around the globe. Banks and other financial institutions are likely to continue to engage the proposals themselves, as well as with the legislative members that are considering whether or not to implement them. In particular, these parties may aim to clarify the scope and timing of any amending legislation while planning how to potentially mitigate environmental risks associated with lending.

### **Outbound Investment Reform**

Finally, China has formally outlined new rules with respect to overseas investments. China's National Development and Reform Commission, Ministry of Commerce, Ministry of Foreign Affairs, and the People's Bank of China have jointly issued an Opinion on Further Guiding and Regulating Outbound Investment (the Guiding Opinions), in order to endorse foreign investment in strategically important areas while also discouraging (or explicitly banning) other investments perceived to conflict with China's national interests.<sup>30</sup>

The Guiding Opinions classify overseas investments within one of three categories: "encouraged," "restricted," or "prohibited." Transactions that fail to meet the host nation's environmental, energy-efficiency, or safety standards fall within the restricted category. The four issuing bodies will scrutinize these investments more closely, and impose conditions on certain transactions that the People's Republic of China (the PRC) believes threatens its national interests, security, and economic stability. Whether or not China will strictly enforce a restricted category classification when a transaction fails to comply with environmental or energy-efficiency standards remains unclear. However, China's inclusion of host-country regulations in the Guiding Opinions indicates that China is pushing for stronger environmental standards beyond its own borders.

Moreover, following the International Green Finance Seminar in September 2017, the participating parties, including the Ministry of Environmental Protection's Foreign Economic Cooperation Office,

released the Environmental Risk Management Initiative for China's Overseas Investment. This publication consists of 12 articles that set out the relevant principles, such as disclosure of environmental, social, and governance (ESG) information, while encouraging investors to consider ESG factors in investment decision making. The Chinese government is reportedly drafting legally binding regulations on overseas investment, including plans to implement the Environmental Risk Management Initiative's 12 articles to form a detailed operational guide before the end of 2017.

At bottom, Chinese investors will need to consider ESG standards in evaluating outbound investment opportunities as the country seeks to deliver on its promise of sustainable economic development — both domestically and globally.

## **Developments to Watch: Citizen Suits Under President Xi**

Prior to the amendment of the EPL, no clear procedural mechanisms allowed for public interest suits — in fact, many courts rejected such suits altogether. The 2014 revisions of the EPL fundamentally improved the role and scope of participation of nongovernmental organizations, as well as the general citizenry. In particular, Article 58 of the amended EPL provides that Chinese nongovernmental organizations can bring suits on behalf of the public interest in situations involving pollution or ecological damage if the organizations have (1) registered with the civil affairs departments at or above the municipal level within the district; and (2) specialized in environmental protection public interest activities for five or more consecutive years without any recorded violations of the law.<sup>31</sup> Citizens may not individually bring suit pursuant to Article 58, but they may bring administrative public-interest litigation pursuant to the Administrative Reconsideration Law — a venue that, to date, remains largely untested. However, nongovernmental organizations have gained greater access to the court system and an improved ability to advocate for environmental reform. Moreover, the EPL sets out that citizens may report violations to their local environmental protection bureaus and comment on the legislative process, which allow for assistive record evidence to use in environmental proceedings.<sup>32</sup>

Notably, the success of any new efforts to bring environmental litigation will depend in part on the willingness and ability of China's judiciary to find parties liable for their actions. While Article 59 of the EPL imposes compounding penalties against polluters, it only obligates parties to pay penalties upon the order of a court.<sup>33</sup> President Xi's efforts to promote compliance and reduce delay in corrective action in the environmental sphere will be critical in encouraging the lawful process of enforcement actions and independence of the judiciary system.

President Xi's efforts to enhance resources and opportunities for environmentalists while reducing enforcement and prosecution barriers come at a critical time. Under his leadership, China may be able to undertake a thorough and much-needed reform of environmental law and policy, as well as attendant enforcement. Such steps may also help to encourage and strengthen the next generation of Chinese environmental advocates.

Another possible outcome is that local governments could comply with environmental legislation and seek to eradicate violators in response to the EPL's strengthened top-down sanctioning in Articles 26 and 67. Local bureaus may even encourage environmental litigation as a means of more cheaply monitoring and enforcing environmental litigation. However, whether or not China will apply such action consistently remains a question. Under such a scenario, China could see a rise in environmental public-interest litigation that could go a long way toward solving the country's implementation problems.

But even without local-government participation, public-interest litigation could serve a number of useful roles. At a minimum, local public-interest cases, and the media attention they tend to attract, could help

alert higher-level officials to environmental problems. Finally, an increase in environmental suits could trigger more judicial work related to environmental law, which will help the judicial branch to interpret the law and facilitate the law's development in the legislative and executive branches (especially in the MEP).

## **Conclusion**

The developments described above demonstrate the breadth of environmental reforms taking place in China today. From completely overhauling the EPL framework, to rapidly increasing enforcement activity, to launching a nationwide ETS and a new emission permitting system, China is reforming and modernizing every aspect of its environmental policies. Further, China has incorporated environmental protection into its official political ideology while integrating anti-corruption and environmental enforcement efforts. Multinational businesses with operations in China or selling into China should expect that these reforms and increased enforcement activity will continue apace during the “new era” of Xi Jinping’s second term and beyond.

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**Endnotes**

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