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Stricter enforcement of environmental regulations in China

Last year's Party Congress made clear China's commitment to environmental protection: in his opening speech, President Xi Jinping mentioned "environment" 89 times, while "economy" stopped at 70. The new environmental zeal has led to a surge in relocations and shutdowns, impacting companies active in China or heavily reliant on Chinese suppliers. This was illustrated by a recent [Bloomberg](#) article reporting that environmental action had resulted in a sudden shortage of raw material in the solar panel industry, driving up costs and crushing margins for scrambling manufacturers.

Companies active in China should comply with China's new environmental regulations and assertively engage with authorities to prevent potential problems. In addition, companies heavily reliant on China-based suppliers, especially in highly-regulated areas or industries, should actively monitor risks and put precautionary measures in place to mitigate potential disruptions in their production and supply chains.

Changes in environmental policy enforcement

Where previously China's environmental enforcement authorities have been accused of lacking teeth due to the government's unwillingness to interfere with economic growth, this notion has shifted since China's new environmental protection law entered into force on 1 January 2015. In the past, environmental authorities reported to local government heads, who (for various reasons) might use their power to block environmental penalties interfering with their economic goals. Under the new law, however, these local environmental authorities can report directly to superior environmental authorities, removing this potential conflict of interest. Additionally, the new law enables environmental NGOs to pursue legal action - which could cause legal and reputational damage - against companies violating national environmental regulations.

The 2015 developments led to much stricter environmental enforcement in the following years. Since July 2016, four rounds of dawn raids and on-site inspections have penalised some 18,000 polluting companies. Moreover, shutdowns and relocations resulting from enforcement of environmental regulations have drastically increased since May 2017, affecting industries such as textiles, chemicals, plastics, coating, paper, rubber, metals, dyeing, painting and printing.

This trend is set to continue in the coming years as numerous new regulations and guidelines come into force. On 20 September 2017, China's State Council released its

"Opinion Concerning Establishment of a Long-Term Mechanism for Early-Warning and Monitoring of Environmental and Natural Resources Carrying Capacity". This opinion gives government authorities the power to suspend major projects in heavily-polluted areas. The opinion also states that companies responsible for damage to the environment, and local officials that fail to uphold the ban, may face criminal liability. Another development is China's new environmental tax law, which came into force on 1 January 2018. This law increases the tax burden on entities that emit air, water, solid waste, or noise pollution, while granting preferential tax treatments to polluters which drastically reduce their emissions. Finally, the State Council issued "Instruction 77 for Relocation of Hazardous Chemical Enterprises in Heavily Populated Areas" in August 2017, which addresses the relocation of hazardous chemical entities at a local level. Entities that create significant potential risks to the population must relocate by 2020, while larger entities need to move by 2025.

Assessment and outlook

Given the wide discretion of the enforcement actions, assertive engagement is crucial in dealing with China's local government and environmental authorities. The increased importance of environmental protection will not only result in more inspections and enforcement, but is likely to have an impact on all regulatory approval. A satisfactory environmental narrative might very well become a key driver in establishing any form of government cooperation. For this reason, it is essential for companies to be proactive when addressing environmental protection. Proactive communication will not only help drive the conversation, but will also make the authorities more willing to collaborate.

From an operational perspective, China's environmental crackdown has hit companies at every level, resulting in serious disruptions to supply chains, including for foreign multinationals. In addition to the example provided above, the SCMP recently reported that as a result of a forced shutdown of a Chinese supplier of a global car parts manufacturer, the production of more than 200 car models of 49 brands were affected. As this new enforcement trend is set to become the new norm, it is essential for companies to ensure that they not only comply with relevant regulations and guidelines themselves, but also audit their business partners' compliance. In doing so, companies should be aware that even if they (or their business partners) comply with all existing legal requirements, they may still be subject to relocation; especially if a company operates in a highly-regulated area or industry, as relocation can sometimes be driven by unrelated (and thus more unpredictable) policy considerations. In this respect, supply chain management is key. As a sudden shutdown of a business partner can disrupt an entire production chain, it is crucial to carefully screen the complete supply chain for environmental compliance at both national and local levels and to ensure that any business partners have all the required licences. Depending on the standing of a company's suppliers, contingency planning might be necessary.