



ERM INSIGHTS

“Comply or Close”- the New Reality for Industrial Facilities in China

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Abstract

Chinese Authorities are increasingly shifting their focus from permitting of industrial facilities to ensuring operational compliance. These changes mark a significant departure from the Ministry of Environmental Protection’s long-standing policy of focusing on permitting for new facilities with minimal monitoring of environmental compliance over the operational life of industrial facilities. Year to date, almost 6,500 industrial facilities have been ordered to suspend or shutdown operations across the country for violations of environmental regulations, causing major disruptions to supply chains in China. This changing regulatory landscape creates new challenges for business and requires reassessment of the way in which environmental compliance is managed and monitored.

“Comply or Close”- the New Reality for Industrial Facilities in China

Chinese Authorities are increasingly shifting their focus from permitting of industrial facilities to ensuring operational compliance.

Recent State Council reforms have pursued the parallel objectives of simplifying “green tape” associated with environmental permitting of new industrial developments while at the same time implementing supervision measures to promote operational compliance with environmental regulations for existing facilities.

These changes mark a significant departure from the Ministry of Environmental Protection’s (MEP) long-standing policy of focusing on permitting and approvals for new facilities with minimal monitoring of environmental compliance over the operational life of industrial facilities.

Plant Managers at industrial facilities in China have long known that failing to abide by environmental standards set by MEP is unlikely to land them in hot water. With few resources available to monitor facilities themselves, local authorities have generally left industrial facilities to self-report discharges to the environment with minimal supervision. The result has been a steady deterioration in the environment that has accompanied China’s industrial development. That changed earlier this year. Self-reporting is out and Central Government Inspections are in as China’s MEP gets tough on polluting facilities.

Self-reporting of environmental compliance is out and Central Government Inspections are in as China’s Ministry of Environmental Protection Gets Tough on Polluting facilities.

In the first three quarters of 2017, almost 29,000 violations have been issued under the new Environmental Protection Law. Penalties include plant shutdowns, confiscation of company property and fines. Local officials and managers (both at Chinese and foreign facilities) have been detained. The numbers speak for themselves. Year to date, almost 6,500 industrial facilities have been ordered to suspend or shutdown operations across the country. Almost 6,300 administrative detentions have been ordered, a year-on-year increase of 170%. In Shanghai alone, over 21,000 inspections have been conducted between January and October 2017.

Legal Basis and Likely Future Trends

In 2016, a Central Environmental Inspection Group was established following the 14th National People’s Congress, which called for greater accountability for the pollution of China’s air, soil and water. Since its establishment, the Central Environmental Inspection Group has completed a nation-wide inspection of all 31 Provinces, resulting in prosecution of over five thousand enterprises and fines of over RMB2.8 billion (\$450 million) being ordered. In addition to

government inspections, the public is being encouraged to report issues of environmental non-compliance.

To avoid the severe air pollution experienced in northern China in the winter months, expert teams have been established to track and monitor air emissions in “26+2 cities” in the Beijing and Tianjin metropolitan areas. This follows concerted efforts over the last few years to reduce sources of air pollution including the relocation of all coal fired power from Beijing Municipality and the conversion of the last of Beijing’s coal-fired district heating furnaces to natural gas in 2015. Over 5,600 inspectors have been recruited to conduct inspections over the winter months to ensure that emission control measures are implemented as directed.

Water Pollution Prevention and Control Action Plans are in effect and a general improvement in water quality was reported in the first half of 2017. MEP Inspectors have been dispatched to those regions that fell behind annual water pollution control targets. Where violations are identified, MEP has the authority to suspend the power of local officials to grant approvals for new industrial projects (and this has been done in several cities). The Yangtze River Delta is a focus of this activity, with particular attention is being paid to paper, steel, pharmaceuticals, dyeing and printing, leather and chemical industries.

The long-awaited Soil Pollution Prevention Law was gazetted for public comment over the summer months and a timetable has now been published for it to come into force. The law requires provincial agencies to create and maintain a publically available register of contaminated sites. Industrial facilities suspected of soil or groundwater contamination will be required by local environmental authorities to undertake environmental surveys and report these to the authorities who will in turn make the survey results publically available through a register of contaminated sites. Anecdotally, local authorities are already requiring soil and groundwater investigations for certain industries in advance of the law coming into effect.

Implications for Business

The changing regulatory landscape creates new challenges for business and requires reassessment of the way in which environmental compliance is managed and monitored.

Suspension and closure of polluting facilities creates supply chain risks for manufacturers, with several of ERM’s clients reporting severe business disruption. Hi-tech manufacturing and technology industries with complex supply chains that operate lean inventory models are particularly exposed. ERM clients are already looking closely into their supply chain for potential risks.

Additional investment in maintaining or improving pollution control equipment is an obvious implication. Multinational clients are rushing to implement EHS compliance audit programs and reviewing the adequacy of systems, staff and resources in place at their facilities in China.

Companies investing in new facilities should take these regulatory and enforcement trends into account. Authorities are now much more selective about the type of facility that can be built in particular development zones. Projects that are incompatible with newly issued planning guidelines face the risk not being approved or, worse still, relocating once operational.

About the Authors

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Dr. Cherry Hu is responsible for ERM China's Regulatory Advisory Services. Prior to joining ERM in 2008, Dr Hu was an official with China's Ministry of Environmental

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Mr. Piers Touzel has helped multinational clients identify, assess and manage EHS risks in China for over 17 years. He advises industrial clients, investors and financial institutions on the financial implications of sustainability challenges associated with the establishment of new facilities as well as acquisitions and divestitures. Mr. Touzel splits his time between Shanghai, Beijing and Hong Kong.