

Enforcement with Chinese Characteristics: Regulators Continue to Rely on Factory Shutdowns, Restrictions and Relocations to Achieve Environmental Goals

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China has made rapid strides in developing a robust, modern environmental regulatory system over the past decade. This progress includes a policy framework overhaul triggered by the Environmental Protection Law (EPL) in 2014, an ongoing reform of emissions and discharge permitting, a new draft Soil Pollution Law to impose liability for remediation of contaminated land, and the launch of the world's largest emissions trading system in 2017. Policy evolution has been accompanied by both growing public awareness and focus on environmental issues — air pollution and food safety in particular — and the central government's increasingly vigorous enforcement of environmental laws. China's Premier, Li Keqiang, declared war on pollution in 2014. In October 2017, environmental protection was enshrined in official Communist Party ideology as part of "Xi Jinping Thought" — which was added to the party constitution at the 19th National Congress of the Communist Party of China (CPC). More recently, China has added ambitious air quality targets seeking reductions in sulfur and nitrogen dioxides, PM 2.5, and volatile organic compounds (VOCs). The ability of firms to access credit is increasingly dependent on environmental compliance as China's social credit system (SCS) expands to include environmental ratings. Finally, the government is taking steps to protect key ecosystems in China, beginning with the Yangtze River Protection Law, which establishes cross-provincial oversight over environmental issues in the Yangtze River basin, and tightens restrictions on land use in environmentally sensitive areas.

One of the most significant aspects of this stepped-up emphasis on enforcement has been the increased use of factory closures, restrictions, and compulsory relocation as enforcement

tools by regulators tasked with fighting Premier Li's "War on Pollution." This paper analyzes the drivers behind factory shutdowns, restrictions, and relocations in China and the steps companies can take to prepare for, and protect themselves against, enforcement action.

I. INTRODUCTION

The latter half of the 2010s featured some of the largest environmental crackdowns in Chinese history. Planning for these crackdowns began in July 2015, when the Central Leading Group for Comprehensively Deepening Reformsⁱ issued a trial Environmental Protection Supervision and Inspection Plan (the Inspection Plan).ⁱⁱ The Inspection Plan called for inspections across all of China's 31 provinces, targeting both polluting factories and local officials failing to enforce environmental law. That same year, Chen Jining, then the newly-appointed Minister of Environmental Protection (an office that has now been replaced by Minister of Ecology and Environment), vowed that environmental law would not be a "paper tiger" but a "sharp weapon with teeth of steel."ⁱⁱⁱ The government then launched the first of four nationwide environmental inspections at the end of 2015, with the last phase — in which tens of thousands of factories were temporarily shut down — ending shortly before the 19th CPC Congress in October 2017. Some estimates suggest that around 40% of the country's factories were forced to shut down at some point by 2017, and as many as 70,000 factories were reportedly shut down in the provinces of Hebei, Henan, and Shandong alone.^{iv}

In March 2019, the current Minister of Ecology and Environment, Li Ganjie, announced that a second three-year phase of environmental enforcement inspections would begin that year, and would be followed by "reviews" of how violations identified during the inspections have been addressed.^v Significantly, Vice-Minister Zhai Qing has indicated that the second three-year phase of inspections will focus on state-owned enterprises and government ministries. However,

feedback that we have received suggests that these inspections will also “look back” to check whether issues identified in the previous inspection have been satisfactorily addressed or not. Vice-Minister Zhai Qing has also pledged to apply strict enforcement measures to all violators, regardless of size or the prestige of the company.^{vi}

These facility closures have become a major challenge for local and multinational manufacturers in China. Many small and medium-sized enterprises have been slow to adapt to the new wave of environmental regulations, and because smaller manufacturers often emit greater quantities of pollutants per unit of production, they have become a focus for regulators. But even companies with state-of-the-art emissions control systems and robust compliance programs have encountered difficulties due to shutdowns of their suppliers and customers—particularly those located in or around certain sensitive regions such as Beijing, and especially during the winter season when ambient air pollution levels are typically higher. Furthermore — because Chinese emissions limits are often enforced at the level of industrial parks — if a park as a whole does not meet emissions targets, the government may order all park facilities to lower emissions or temporarily cease operations.

Since the aforementioned inspection plan implemented in 2015-2017, factory shutdowns have slowed, but not stopped. In addition, safety has been a driving factor in recent shutdowns after the explosion at a pesticide plant in Yancheng, Jiangsu province on March 24, 2019 which killed 78 people, and resulted in permanent closure of the industrial park in which the factory was located. Occurring after an even larger explosion near the port of Tianjin in 2015 killed 165 people, the Yancheng explosion served as a catalyst for additional focus on the chemical industry. Following the explosion, Jiangsu province issued a plan to reduce the number of chemical plants in the province (numbering more than 5,000) by 50% by 2020 and by 80% by

2022. Despite the increased focus on safety, Ministry of Emergency Management statistics indicate that between 2016 and 2018, more than 620 chemical plant accidents have occurred in China, resulting in 728 deaths.^{vii} Similarly, Beijing has closed 2,465 factories operating in “ordinary” (*i.e.* low-margin/high-pollution) industries and has issued plans to close a further 1,000 manufacturing facilities by 2020.^{viii}

II. POLICY DRIVERS OF FACTORY SHUTDOWNS

Although Chinese environmental policy is primarily implemented by provincial and local Environmental Protection Bureaus (EPBs), the policy changes of the last few years have been driven in large part by ambitious goals set by top leadership at the State Council and the Ministry of Ecology and Environment (MEE, the successor to the Ministry of Environmental Protection, or MEP). For example, China's highest policy-making body, the State Council, issued the Action Plan for Air Pollution Control^{ix} and the Action Plan for Water Pollution Control^x in 2013 and 2015 respectively. Each plan established requirements for 10 types of pollution control methods related to air and water pollution. More recently, the Three-Year Action Plan to Win the Defense of the Blue Sky (Blue Sky Plan) was issued by the State Council in June 2018, calling for the relocation or closure of "heavily polluting" enterprises currently located in urbanized areas and prohibiting the construction of new "chemical parks in key areas." The Blue Sky Plan sets aggressive emissions reductions targets for 2020, including a 15% reduction in both sulfur dioxide and nitrogen oxides from 2015 levels. It also sets goals at the city-level, including reducing the number of cities with PM 2.5 above target levels by more than 18%, reaching a rate of 80% of days with "excellent" air quality in cities at-or-above the prefecture level and reducing the number of "severe" pollution days in cities at or above the prefecture level by at least 25%, in each case as compared with 2015 levels.

New regulations have also sought to address the growing issue of VOC emissions. The Blue Sky Plan, for instance, contains an outright prohibition on the use of high-VOC, solvent-based coatings, inks, and adhesives in "key areas." The Blue Sky Plan also calls for a nationwide reduction in VOCs of at least 10% from 2015 levels by 2020, and for the development of

mandatory national standards for VOC content limits for coatings, inks, adhesives, cleaning agents, “and other products,” drafts of which were issued by the Ministry of Industry and Information Technology on November 13, 2019, with implementation in “key areas” in July 1, 2020. The MEE issued the Comprehensive Control Plan for Volatile Organic Compounds (the VOC Control Plan)^{xi} in 2019 as part of the implementation and enforcements of the State Council’s Blue Sky Plan. The VOC Control Plan requires the implementation of mandatory VOCs standards in certain industries—notably, petrochemical, chemical industrial coatings, packaging, printing, oil storage, and transportation—and the strengthening of VOC management in the automobile, furniture, container, electronic products, construction machinery, “and other industries.” With respect to industrial parks, the VOC Control Plan requires MEE to set standardized industry benchmarks for park management, develop comprehensive improvement programs, and issue guidance on the upgrade of industrial parks and clusters. It also calls for the improvement of monitoring capabilities in these areas.

Because MEE lacks the staff to effectively monitor the entire country, enforcement falls primarily to local officials, who have come under increasing pressure to enforce environmental laws and achieve environmentally-based performance goals. The EPL, for example, provides that government officials who fail to properly supervise regulated companies may face demotion, financial penalties, or even criminal sanctions. Indeed, the central government investigated more than 18,000 Chinese officials during the environmental crackdown in 2017. MEE conducted these latest investigations in conjunction with the Communist Party’s primary anti-corruption task force, the Central Commission for Discipline Inspection. This cooperation highlights the overlap between increased environmental enforcement and President Xi’s larger anti-corruption campaign. The performance of government officials is now also assessed on the basis of air

quality and other environmental metrics, in addition to, and sometimes more prominently than GDP growth. The Action Plan for Water Pollution also ties funding for pollution control equipment to implementation of the plan to incentivize active enforcement.

In order to meet their ambitious targets, local EPBs and officials have sought broad regulatory powers to ensure compliance. For example, Jiangsu Province issued a plan to “shut down a series of chemical industrial factories, relocate a series of chemical industrial factories, upgrade a series of chemical industrial factories, and restructure a series of chemical industrial factories” (the Four Series Plan).^{xiii} EPBs and officials have also targeted particular industries for more stringent emissions limits and potential shutdowns. The Action Plan for Water Pollution, for example, targets facilities engaged in paper-making, coking, nitrogenous fertilizer, nonferrous metals, printing and dyeing, agricultural and byproducts processing, the manufacture of active pharmaceutical ingredients, tanning, pesticide, and electroplating for regulatory scrutiny and potential closure.

Enforcement actions in China have also historically been tied to major events of national significance. Prior to the Beijing Olympics in 2008, cars were restricted by license plate number in Beijing, and factories in surrounding provinces were shuttered for several months leading up to the games to maximize the chances of clear skies. Similar efforts before the Asia-Pacific Economic Cooperation meeting in Beijing in 2014 led locals to coin the term “APEC blue” for the color of the sky during the period surrounding factories were shut down. Multinationals should expect these types of temporary pollution reduction efforts around key events to continue.

Recently, authorities have also begun to issue policies imposing lower production limits or requiring shutdowns during the winter, when older, district-wide heating systems are

activated, leading to visible increases in ambient air pollution. In September 2017, MEE, the National Development and Reformation Commission (NDRC), the Ministry of Public Security, the Ministry of Finance, Ministry of Housing and Urban-Rural Development, the Ministry of Industry and Information Technology, the Ministry of Transportation and six provincial level governments issued the Action Plan for Comprehensive Control of Air Pollution in Autumn and Winter for 2017-2018 in Beijing, Tianjin, and Hebei Province and the surrounding areas, which was updated for the 2018-2019 season and again for 2019-2020.^{xiii} The plans establish industry-wide production limits during the heating season (typically from November 15 to March 15) for 15 key industries, including steel making, coking, foundry, construction materials, non-ferrous metals, and chemicals. In addition emissions control requirements have been strengthened, with the 2019-2020 plan calling for a reduction in PM 2.5 density of 4% and a 6% reduction in the number of “severe pollution” days. Based on this action plan, local governments in the region are issuing more detailed lists of industries and companies that will be required to curtail or temporarily cease production.

III. RELOCATION ORDERS

The Chinese government has issued policies calling for the relocation of entire classes of companies away from the outskirts or industrial sections of major cities like Beijing and Shanghai to specialized industrial parks far from urban centers due to safety and environmental concerns. These policies suggest that the government recognizes that temporary shutdowns are a stop-gap solution. In 2011, for example, the State Administration of Work Safety issued a plan requiring companies manufacturing hazardous chemicals to relocate to chemical industry industrial parks by 2015. The plan calls for enterprises located in densely populated areas (such as residential and commercial areas) to relocate their facilities unless they can meet strict

emissions limits. In principle, the plan requires all medium and small enterprises, and large enterprises in high-risk industries, to relocate by the end of 2020. By 2025, *all* companies manufacturing hazardous chemicals must relocate to industrial parks equipped for this purpose.

More recently, the State Council issued a Guiding Opinion on Pushing Forward the Relocating and Transforming of Hazardous Chemical Manufacturing Companies Located in Densely Populated Urban Areas (the Guiding Opinion).^{xiv} The Guiding Opinion calls for local governments to support relocation efforts by offering financial support for relocation, and offering tax breaks to offset the costs, and for banks and financial institutions to offer support through lending and encouraging bond issuances. China also has a national Regulation on the Expropriation of Buildings on State-owned Land and Compensation, which entitles the owners of a building to compensation for not only the value of the building, but for production losses and relocation costs.^{xv} In some cases, this compensation scheme appears to have worked well - Shanghai Hutchison Pharmaceuticals Limited reached a land compensation agreement with the Shanghai government in December 2015 under which it would receive a total of \$113.1 million in subsidies to give up its remaining 35 years of land use rights at a site within the city and relocate to a new \$95 million factory in the suburbs.^{xvi}

Implementation, however, remains uneven. Many cash-strapped local governments may have trouble offering meaningful compensation to factories forced to relocate. For example, in an implementing regulation issued in December 2017,^{xvii} the government of Yunan Province issued a plan to implement the Guiding Opinion which proposed to offer compensation of just 200-300 RMB per square meter of the facility's footprint. As a result of funding shortfalls, implementation has proceeded very slowly, with many facilities identified for relocation in provincial implementation plans not even having started the process of moving for lack of

capital, despite a deadline less than three years away.^{xviii} Unless funding for relocation of such facilities can be secured, either through government assistance or through lending institutions, some facilities may simply shut down and not reopen.

In comparison with national relocation policies, which are generally financed by the central government and enforced systematically across an industry, provincial EPBs have generally required certain non-compliant factories to relocate at their own cost. For example, Nantong Xingao Dyeing Co., Ltd. of Nantong City, Jiangsu Province, was put on a Key Pollution Rectification Project List by the local EPB, and subsequently ordered to relocate in 2017 with no apparent financial support or compensation from the local government. As a result, the company was forced to wind-down production at its facility and relocate at its own expense. The Draft Yangtze River Protection Law, which was issued for public comment in January 2020, provides another example. The new law would impose stringent measures on various pollution-related factories and restrict the locations and modifications of factories, new and existing, in the greater Yangtze River Basin region. Although not yet in its final form, it is likely that the law will bring stricter environmental regulations to this area and present another set of considerations for companies directly operating, or with supply chains located in, the area.

IV. SOCIAL CREDIT SYSTEM

Since 2014, China has been developing and implementing a comprehensive “social credit system” (the SCS), as set forth in the State Council’s Plan for Establishing a Social Credit System (the SCS Plan). The SCS applies credit ratings, both to individuals and businesses, using social, political, and legal compliance factors, including environmental performance. The SCS means that going forward, a comprehensive and cross-sector system of rewards and sanctions

will be available for companies operating in China, based on a comprehensive assessment of their social behavior and compliance with laws.

Environmental factors have been key aspects of the SCS from its incorporation, with the Trial Measures for Enterprise Environmental Credit Assessment, issued by the former MEP, the NDRC, the People's Bank of China (PBOC), and the China Banking Regulatory Commission (CBRC), having been first proposed in 2013. These measures were followed by the Guiding Opinions on Strengthening the Construction of Enterprise Environmental Credit System (Credit System Guiding Opinions), issued by the former MEP and NDRC in 2015, which called for the comprehensive implementation of an environmental credit system by 2020. Environmental information utilized by the SCS will include construction project environmental management; environmental protection permits; nuclear and radiation safety management; sewage charges; and environmental protection tax payments. For certain enterprises, information relating to pollution monitoring, key pollutant discharge unit monitoring, access to and use of special funds for environmental protection and environmental risk management information will also be included.

Possible sanctions for firms with poor environmental ratings under the SCS include possible prohibition from participating in government procurement activities, and restrictions on the granting of operating permits. Public disclosure of poor environmental records and violations is also contemplated; for example, the VOC Control Plan states that information regarding violations of the plan by firms and the personnel responsible for such violations will be publicly available as part of the SCS. For firms with strong environmental performance, the SCS includes carrots as well as sticks. For instance, firms with good environmental credit may have access to preferential pollution liability insurance (poor performance will result in rate

increases), and less frequent inspections of manufacturing facilities. A strong compliance record will also result in an enterprise being eligible to receive “active credit support,” while enterprises with a lesser rating could suffer strict loan conditions and may not be granted new loans until rectification measures are implemented to improve environmental standing.

V. ADAPTING TO THE REGULATORY ENVIRONMENT

Firms operating in China cannot eliminate the risk and unpredictability of regulatory shutdowns, restrictions, or relocations, but they can reduce and mitigate the effects by taking proactive measures. *First*, companies need to be attuned to the regulatory environment and local regulators’ policy directives. Compliance with current regulations is not enough — firms need to “see where the ball is going” in order to anticipate regulators’ next area of focus. *Second*, companies need to understand not only their own regulatory compliance obligations, but also any emissions limits or requirements that apply to the industrial park or district in which they are located. Although firms cannot control whether their neighboring facilities stay within the applicable limits, they can increase their ability to anticipate the periods or reasons for which regulators will seek to curtail production. *Third*, companies need to identify and engage competent local counsel that is familiar with both the regional personnel and the practices of the local regulator. Because local priorities and the discretion of local regulators drive so much of the uncertainty in enforcement activity in China, these relationships and a local familiarity can prove critical in preparing for and responding to enforcement actions. *Fourth*, strategic consideration should be given to the flexibility and resiliency of companies’ supply chains to be able to adapt if the operations of upstream suppliers or downstream customers are disrupted by factory slowdowns or shutdowns. *Fifth*, firms should prepare and train employees on response plans to handle surprise regulatory inspections and the aftermath of such inspections.

Fortunately, despite the widespread use of factory shutdowns, restrictions, and relocations, there are indications that MEE is aware of the issues created by unpredictable closures and the potential impact on China's position as the world's preeminent manufacturer. The Director General of MEE's Department of Law and Policy, Bie Tao, has stated that MEE "opposes reckless law enforcement by simply shutting down polluting companies," and has called such shutdowns "irresponsible and capricious."¹ Although MEE remains under-staffed in comparison to agencies such as the United States Environmental Protection Agency, the agency has increased its oversight and authority over local EPBs, and factory shutdowns may become a focus of this effort in the future. MEE has also made efforts to harmonize environmental performance standards and enforcement across the country, for instance, through the requirement to issue standardized requirements for industrial parks under the VOC Control Plan. Greater consistency in enforcement standards is a welcome development, and multinationals should engage with MEE to support its efforts to increase transparency and consistency in Chinese environmental law enforcement.

*[*This article was prepared in conjunction with Scott Fulton and Zhuoshi Liu of the Environmental Law Institute, Washington, D.C. and George Zhu and Carey Ni of JunHe LLP.]*

¹ This feedback reiterates comments made to the China International Business Dialogue on Environmental Governance (CIBDEG), as part of its ongoing work to facilitate dialogue on emerging law and policy issues between multinational corporations and Chinese authorities.

ⁱ 中央全面深化改革领导小组

http://www.gov.cn/xinwen/201507/01/content_2888298.htm?from=singlemessage&isappinstalled=0

ⁱⁱ http://www.gov.cn/xinwen/201507/01/content_2888298.htm?from=singlemessage&isappinstalled=0

ⁱⁱⁱ www.economist.com/news/china/21648687-new-environment-minister-displays-his-appetite-taking-polluters-saving-fish-and-baring.

^{iv} <http://www.npr.org/sections/parallels/2017/10/23/559009961/china-shuts-down-tens-of-thousands-of-factories-in-unprecedented-pollution-crack> and

<https://www.icis.com/subscriber/icb/2017/09/22/10144670/china-pollution-curbs-a-key-turning-point-for-chemicals/>

^v <http://www.chinadaily.com.cn/a/201903/14/WS5c8a1590a3106c65c34eea6f.html>;

<https://www.reuters.com/article/us-china-environment/china-to-launch-new-round-of-nationwide-environmental-inspections-idUSKCN1TS0GN>

^{vi} <https://www.scmp.com/news/china/politics/article/3016342/china-prepares-next-round-nationwide-inspections-war-pollution>

^{vii} https://www.theepochtimes.com/authorities-to-shut-down-chinese-chemical-industrial-park-after-deadly-blast_2876670.html

^{viii} <https://www.reuters.com/article/us-china-economy-beijing/beijing-to-shut-1000-manufacturing-firms-by-2020-paper-idUSKBN1KK026>

^{ix} 《国务院关于印发大气污染防治行动计划的通知》

^x 《国务院关于印发水污染防治行动计划的通知》

^{xi} 《重点行业挥发性有机物综合治理方案》

^{xii} http://www.jseic.gov.cn/xwzx/zcfb/sjzc/201701/t20170111_208611.html

^{xiii} 《京津冀及周边地区 2017-2018 年秋冬季大气污染综合治理攻坚行动方案》；《京津冀及周边地区 2019-2020 年秋冬季大气污染综合治理攻坚行动方案》

^{xiv} 《国务院办公厅关于推进城镇人口密集区危险化学品生产企业搬迁改造的指导意见》

^{xv} http://www.gov.cn/zwzk/2011-01/21/content_1790111.htm

^{xvi} <https://www.businesswire.com/news/home/20161031005434/en/Chi-Med-Commercial-Platform-Joint-Venture-Receives-US59.5>

^{xvii} http://www.yn.gov.cn/yn_zwlanmu/qy/wj/yzbf/201712/P020171226652103432029.pdf

^{xviii} <https://www.icis.com/resources/news/2017/09/28/10147577/china-chemical-plant-relocation-plans-lack-funding/>