



# International Environmental Law Committee Newsletter

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## MESSAGE FROM THE CHAIRS

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Due to its emergence as a world power and economic behemoth, China's rapid development, investment potential, and severe environmental problems have been frequent media topics over the past several years. News stories about concerning China's impressive economic growth. For business, the development of the rule of law and the scope of its environmental laws are of immense interest. On the ecological front, its attempts to improve the quality of its water and air leading up to the Beijing Olympics, its possible incorporation into a post-Kyoto climate regime, and emergence last year as the largest global emitter of CO<sub>2</sub> have also received widespread coverage. Given its importance, the International Environmental Law Committee of the ABA's Section of Environment, Energy, and Resources and the International Environmental Law Committee of the ABA's Section of International Law have partnered to produce this newsletter focused on China.

We are pleased to present the articles that follow from a diverse group of experts, many of whom are either based in China or have recently spent extended periods of time there. They cover an exciting array of issues related to Chinese environmental law and conducting business with Chinese companies. First, Professor Robert Percival identifies the major environmental problems China faces, its legal and regulatory tools, the obstacles it faces in using those tools to address its pressing problems, and current efforts to improve Chinese environmental law. Former EPA General Counsel Roger Martella similarly discusses the challenges China faces in the development and implementation of its environmental law and, based on his collaboration with Chinese government officials, identifies key components the country must prioritize to establish a more orderly legal system to address the country's environmental problems. Next, Steve Wolfson discusses China's evolving environmental law framework and ongoing collaboration between EPA and China's Ministry of Environmental Protection. Then, Richard Steinwurtzel and his colleagues report on China's developing environmental and labor regulatory framework and provide insight on how to conduct environmental due diligence for transactions involving Chinese companies. Frequent newsletter contributor Charles McElwee describes and comments on China's environmental impact assessment (EIA) requirements, including recent changes to its EIA regime. Carlos Da Rosa provides a clinical view as to the EIA regime and other measures China has taken to open environmental information, based on his experience in a Chinese

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Brett Grosko, Editor**

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university environmental clinic. Finally, Juge Gregg and Amelia Porges provide an informative report on recent amendments to the federal Lacey Act. These little-noticed statutory changes may significantly affect the documentation requirements and regulatory risks for importers of wood products from China (and elsewhere).

Overall, these articles present quite clearly the great challenges China faces in its efforts to grow its economy without sacrificing environmental and public health. Significantly, the articles do suggest that a new generation of environmental leaders is working to address China's problems and ensure a more sustainable future.

We hope you find this issue of our newsletter helpful in your understanding of Chinese environmental law and federal law related to trade with China. We encourage you to attend a session on Chinese environmental law that will be held at the Section of Environment, Energy, and Resources' 16th Section Fall Meeting in September 2008 (which will include several of the authors of this newsletter). Please feel free to contact us if you would like to get involved in our committees' work on any of these noteworthy topics.

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**THE CHALLENGE OF CHINESE  
ENVIRONMENTAL LAW**

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**Robert V. Percival**  
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The enormous environmental problems that have accompanied China's rapid development are readily visible to anyone who has lived or traveled in China. This damage has occurred despite aggressive efforts by the Chinese government to adopt environmental protection laws. One might assume that a country governed by a communist dictatorship would have no trouble enforcing its environmental laws. But the environmental situation in China is far more complicated than that, as I discovered while teaching environmental law as a J. William Fulbright scholar at the China University of Political Science and Law (CUPL) in Beijing.

## **China's Environmental Problems**

Living in Beijing during the last five months, I have rarely seen blue sky because the city is plagued with chronic air pollution that often makes it difficult to tell whether or not it is cloudy. While breathtaking new architectural wonders spring up around the city, tap water remains unsafe to drink even in luxury hotels. Last year the World Health Organization (WHO) estimated that air pollution kills 656,000 Chinese annually, a third of all deaths worldwide from air pollution. WHO also estimated that polluted drinking water kills nearly 100,000 Chinese every year. While well-off residents of Beijing have access to every creature comfort in the world, the U.S. State Department still considers it to be a hardship post largely due to its pollution problems.

The Chinese government has vowed to control pollution in order to host a "Green Olympics." Yet the problem is so enormous that the Chinese are being forced to resort to drastic, temporary measures during the Olympics, such as shutting down factories and construction sites and banning private cars from driving. When construction of the Olympic Village was completed earlier this year, the government proudly announced that athletes staying there would have access to safe drinking water, something that Americans already take for granted, but for which ordinary Chinese will have to wait years.

## **China's Environmental Laws**

In 1979, when it launched the economic reforms that produced China's rapid development, the National People's Congress (NPC) adopted the country's first national Environmental Protection Law. Five years later it enacted the Law on Water Pollution Prevention and Control and in 1987 it passed the Law on the Prevention and Control of Atmospheric Pollution. The NPC replaced China's basic Environmental Protection Law with new legislation in 1989 and during the 1990s it adopted legislation to regulate solid waste, to control noise pollution, and to conserve energy. In 2000 China strengthened its controls on water pollution and in 2002 it adopted an Environmental Impact Assessment Law. In addition to these environmental

laws, China has more than a dozen natural resource protection laws, including a Renewable Energy Law, Water Law, Forest Law, Grassland Law, and Mineral Resources Law.

The NPC meets each March to adopt legislation and environmental laws, which are now a prominent part of each year's legislative package. In 2008 the NPC adopted a new water pollution control law and will soon require a national cap and trade program for controlling emissions of sulfur dioxide. Chinese officials have carefully studied the environmental laws of other countries and have readily borrowed from them. After initially following U.S. models of environmental law, the Chinese government has become more attracted to European approaches that place more emphasis on the precautionary principle. This is reflected in China's Law on the Promotion of Clean Production, its "circular economy" producer responsibility law, and legislation requiring pre-market testing of chemicals similar to the European Union's far-reaching REACH program.

## **Obstacles to Implementing and Enforcing China's Environmental Laws**

China's State Council, the branch of government responsible for issuing regulations, has promulgated more than fifty administrative regulations dealing with environmental protection. It reports that as of spring 2008 there were more than 660 local and sectoral regulations and over 800 national standards related to environmental and resource protection. Why have these laws and regulations not been more successful in controlling China's burgeoning environmental problems? Several factors have contributed to this problem.

The initial generation of Chinese environmental laws largely consisted of statements of general principles that were ambiguous and difficult to enforce. China's economic boom roared forward faster than these laws could be implemented and enforced. Enforcement concerns were divorced from the process of lawmaking. At a conference on improving China's environmental laws, I witnessed one of the NPC organizers rejecting a suggestion to include

enforcement in future conferences by stating that the job of the NPC is to write the laws, not to enforce them.

Even after national environmental legislation was strengthened, it has proven difficult to enforce because of the highly decentralized nature of China's government. Most enforcement is the responsibility of local authorities who often fear that environmental regulation will disadvantage local firms. China may serve as a testament to the validity of the "race to the bottom" hypothesis that was a factor in centralizing environmental regulation in the United States. Some local officials have even encouraged companies to pay small emissions charges rather than operate pollution control equipment because the charges provide revenue for local governments.

Penalties for environmental violations in China are still so low that it often is far more economical to pay the small penalties rather than to comply with the law. Fines for water pollution violations were long capped at 100,000 Renminbi (RMB) (\$14,500), a ceiling recently raised by new legislation. However, efforts to persuade the Chinese government to adopt the U.S. Environmental Protection Agency's (EPA) policy of ensuring that fines at least recoup the economic benefit of non-compliance are as yet unsuccessful.

China's national Ministry of Environmental Protection (MEP) has few direct enforcement authorities and a very small staff. In July 2008, MEP was allowed to expand from 250 to 300 employees. By contrast, EPA has 17,000 employees for a country with less than one-fourth the population of China. MEP has many contract employees and is now establishing regional offices, but it actually operates more like the U.S. Council on Environmental Quality (CEQ) than EPA. Like CEQ, it must rely almost entirely on its ability to persuade other, more powerful agencies and officials to act. To be sure, MEP's predecessor, the State Environmental Protection Agency (SEPA), occasionally did make waves by launching "environmental storms." In 2005 it suspended approval for twenty-two energy projects and in 2007 it suspended eighty-two steel and chemical projects for failing to comply with environmental assessment requirements. But these "storms" were temporary and

undertaken in part to cool down an overheating economy.

Chinese environmental officials lack much of the supporting infrastructure that helps to ensure implementation and enforcement of U.S. environmental laws. While there have been many public protests concerning environmental problems, the general public in China is not well educated about environmental concerns. The number of non-governmental organizations (NGOs) focusing on the environment is growing, but they lack the resources and influence of environmental NGOs in the United States. NGOs may operate only with the permission of the Chinese government and can be shut down at any time for no reason. Chinese tax laws do not encourage donations to NGOs, and government censorship of the media can make it difficult for NGOs to publicize problems. In June 2008, a Hong Kong-based NGO called Civic Exchange issued a report on the health consequences of pollution in the Pearl River Delta. The report was headline news on CNN International but was not mentioned in the state-run Chinese media. NGOs lack the legal tools they have in the United States because there are no express provisions for citizen suits to enforce the Chinese environmental laws. China also lacks an independent judiciary and a tradition of respect for the rule of law.

The result is described in a frank "White Paper" on "Promoting the Rule of Law" that the State Council issued in February 2008, which stated: "in some regions and departments, laws are not observed, or strictly enforced, violators are not brought to justice; local protectionism, departmental protectionism and difficulties in law enforcement occur from time to time; some government functionaries take bribes and bend the law, abuse their power when executing the law, abuse their authority to override the law, and substitute their words for the law . . ." (State Council, Promoting the Rule of Law (Feb. 28, 2008)).

### **Efforts to Improve Chinese Environmental Law**

The good news is that the Chinese government now is moving aggressively on many fronts to overcome the obstacles to implementation and enforcement of its

environmental laws. This movement was spurred in part by embarrassing incidents including a major benzene spill in the Songhua River in November 2005. The spill, which local officials initially sought to conceal, created an international incident with Russia and forced a four-day cutoff of water supplies to Harbin, a city of nearly 5 million people. The Chinese government responded by imposing national environmental reporting requirements and encouraging greater openness about environmental problems. Further impetus toward reforming China's environmental laws was provided when it was revealed that the country badly missed the first-year goals for reducing pollution that are contained in its 11th Five-Year Plan (2006-2010).

Chinese media, including the English-language *China Daily*, now report aggressively about environmental problems and the importance of devoting more resources to combating them. The national government has been remarkably tolerant of environmental protests by the public, including flash mobs that helped block the siting of a chemical plant in Xiamen. However, local authorities arrested and imprisoned Wu Lihong, an environmental activist who protested local officials' failure to control pollution that caused a massive algae bloom in Lake Taihu.

Some Chinese NGOs are aggressively pursuing environmental issues. Wang Canfa's Center for Legal Assistance to Pollution Victims (CLAPV) operates a hotline that fields environmental complaints from ordinary citizens. CLAPV frequently goes to court to seek redress for these complaints even in the absence of clear legal authority for citizen suits. While many courts rebuff the group, it has won some important victories, much like the pioneering lawyers for U.S. environmental groups in the late 1960s. Ma Jun's Institute of Public Policy focuses on publicizing environmental violations, which the Chinese media eagerly report when the sources are multinational corporations.

In March 2008 SEPA was upgraded to full ministry status with the creation of a Ministry of Environmental Protection (MEP). While many details of MEP's new powers remain to be worked out, the Chinese

government has pledged to increase its authority at the expense of competing agencies like the powerful National Development and Reform Commission (NDRC). For now the effect has been largely just a change of name with MEP still trying to figure out its functions, personnel, and other issues, questions that are not clearly answered by any underlying law.

MEP has some progress to report. In June 2008 its Report on the State of the Environment in China disclosed that emissions of sulfur dioxide declined by 4.7 percent in China in 2007 and emissions of water pollutants declined by 3.2 percent. The percentage of coal-fired powerplants using technology to reduce their sulphur emissions increased to 48 percent from 12 percent two years before. During the same period the percentage of cities with wastewater treatment increased from 52 percent to 60 percent. Yet, MEP conceded that pollution of the country's major rivers—the Yangtze, Yellow, and Huaihe rivers—is serious and not improving, and that lake pollution and pollution in rural areas also remains severe.

MEP officials have been encouraging greater participation by the public on environmental issues. A new Open Information Law, which became effective on May 1, seeks to provide for public access to information possessed by government agencies. The law is virtually identical to the U.S. Freedom of Information Act, but for an exception for information whose release might undermine "social stability." In May of this year I spoke at a conference in Shanghai where MEP officials explained to environmental NGOs and environmental journalists how to use the law. Representatives of these groups complained that it heretofore has been difficult even to obtain copies of environmental impact assessments, something that hopefully will change as the new law is implemented. Sometimes there is less than meets the eye in new environmental legislation. China's new water pollution law supposedly authorizes class actions, but it also appears to bars lawsuits over problems that were known by the plaintiffs.

Chinese law has not yet developed to the point where there is a substantial private bar specializing in environmental law, aside from lawyers working on

Clean Development Mechanism of the Kyoto Protocol projects on behalf of foreign investors. Yet as Chinese environmental law matures, the demand for environmental lawyers should increase dramatically. The Chinese Ministry of Education is now requiring that all law schools in China teach environmental law, which may temporarily strain the supply of qualified professors. The environmental law students I taught were truly extraordinary and if they are at all representative of the future generation, there is room for considerable optimism. Environmental education also is expanding outside of law schools. Groups like Shanghai Roots & Shoots are working on environmental education in Chinese primary schools and Yao Ming, the country's most revered hero, now appears on billboards urging Chinese to eschew shark fin soup to protect endangered species.




## Conclusion

China has come a long way since the days of Chairman Mao's campaign to "subdue nature." While Chinese environmental law is now moving in a positive direction, it will take considerable time before environmental conditions in China improve substantially. The question is how much damage will be done in the interim, a question that increasingly affects the entire planet. Transboundary pollution from China already is a serious problem—nearly one-third of all mercury in the western United States originates in Chinese coal-fired powerplants. Last year China became the largest source of greenhouse gas (GHG) emissions in the world, surpassing the United States by a whopping 14 percent. When the nations of the world meet in Copenhagen next year to negotiate a successor to the Kyoto Protocol, it will be absolutely critical for China to commit to reducing its GHG emissions, even though on a per capita basis they are much lower than those of the United States. While many believe that it will be impossible to get the Chinese to make such a commitment, China's emissions are now so large that they will have to do so to avoid potentially catastrophic consequences for their own environment.

Environmental law in China today bears some similarities to environmental law in the United States in the early 1970s when its basic infrastructure was being

erected. In both countries environmental policy has evolved from ad hoc efforts to relocate polluting industries to emphasis on end-of-the-pipe pollution controls, followed by efforts to encourage process changes to achieve source reduction. To secure truly dramatic changes in environmental conditions, China will have to integrate environmental concerns more closely into its energy, land use, transportation, housing, and tax policies that affect environmental conditions far more than environmental law and regulation. China has adopted ambitious plans to improve energy efficiency, reduce pollution, and produce more energy from renewable sources. But it also has demonstrated that it is much easier to adopt plans and environmental laws than it is to develop the supporting institutions—such as strong NGOs, effective administrative agencies, an independent judiciary, an environmental bar, and an informed public—that are necessary to ensure their effective implementation and enforcement.

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**LIKE TO WRITE?**

The International Environmental Law Committee welcomes the participation of members interested in preparing this newsletter. If you would like to lend a hand by writing, editing, or identifying authors or issues, please contact the editor, Brett Grosko, at [Brett.Grosko@usdoj.gov](mailto:Brett.Grosko@usdoj.gov).

## THREE FUNDAMENTAL PILLARS FOR A BETTER ENVIRONMENTAL LAW FRAMEWORK IN CHINA

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**Roger R. Martella, Jr.**  
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While many spectators eagerly have anticipated the athletic competition of the Beijing Olympics this August, others have focused more attention on different types of performance statistics: air quality indexes, chemical oxygen demand figures, and particulate matter measures. The Beijing Olympics have drawn attention not only to China's remarkable growth and economic accomplishments, but also to the cost of such growth to the environment.

There is much discussion about the critical condition of the environment both in Beijing and in greater China. By way of example, it is estimated that 75 percent of urban Chinese citizens breathe air violating Chinese national air quality standards. China produces more organic water pollution than India, the United States, and Japan combined. Against this backdrop, China is additionally planning to build more than 500 coal-fired power plants before 2020.

But the pathway to a better environment for China is as unclear as the sky around Beijing on a typical day. There is no shortage of strong legal talent focused on solutions, both in China and abroad. Despite some misimpressions to the contrary, Chinese academics and government officials focused on environmental issues express extraordinary motivation toward developing solutions. And to complement their efforts, some of the United States' top environmental law scholars are working full time in China on finding answers.

Yet, the major stumbling block may be the country's skeletal rule of law. Without the backbone legal tools required to implement and enforce a broad legal framework of any type, implementing and enforcing an environmental legal framework becomes increasingly daunting.

In all, for there to be a strong environmental law framework in China, it increasingly appears necessary

for there to exist—first—a stronger general legal framework for the nation as a whole. The former seems less likely to occur without the latter. And while most observers would take the position that China's environment cannot wait for the establishment of a more orderly legal system, in the context of environmental laws the country must prioritize three components in order to implement a command and control system:

1. a system of cooperative federalism between the national and local governments;
2. a system of permitting and enforcement at the local level; and
3. a system of public participation that provides transparency into environmental decisions.

### Cooperative Federalism

A pervasive theme in the strongest environmental law frameworks worldwide is cooperative federalism. While these frameworks take differing forms depending on local governments and politics, broadly speaking, the methods are the same:

- a national government sets standards ensuring a floor for environmental protection for the nation;
- the national government typically delegates the responsibility for meeting the national standards to a local government, such as a state or province;
- the local government typically has the option of imposing more stringent standards within its jurisdiction; and
- critically, the national government retains some sort of oversight over the local government to ensure the national standards are met, thus ensuring a level of environmental protection for all citizens.

It is perhaps the last item that can present the most challenges for a nation without a strong underlying rule of law.

In the United States, the enforceability of national standards by state governments has been established since the enactment of command and control environmental laws such as the Clean Air and Clean

Water Acts. In these statutes, Congress set up a series of checks by which the federal Environmental Protection Agency (EPA) ensures states are implementing the national standards. Congress has given EPA certain tools to enforce these standards, including the ability to take over local environmental implementation, withdrawing critical funds and grants, and, as a last resort, even limiting the disbursement of transportation moneys. For these reasons, states' motivation to meet—and frequently exceed—national standards is almost taken for granted.

In China, however, the gaps in the general rule of law lead to gaps in the ability of the national Ministry of Environmental Protection (MEP) (formerly the State Environmental Protection Agency (SEPA)) to enforce the standards set for the provincial and municipal Environmental Protection Bureaus (EPBs). Government officials and scholars have found no mechanism in the Chinese legal system by which the national government can impose such standards on local governments beyond setting aspirational goals. And while the EPBs likely will communicate efforts aimed at meeting or exceeding national standards—to the extent they exist—the system breaks down without an ability for the national government to retain oversight over the EPBs. To make matters even more challenging, the EPBs report to their local supervisors, who in turn are accountable to the national government not for environmental protection, but economic growth.

As something of a bypass around this missing link in the Chinese legal system, various academics have proposed alternatives to achieve roughly the same result. One of the most prevalent was an experiment known as “green GDP.” Under this approach, local governments would be assessed not only based on economic growth, but also based on environmental quality in their jurisdictions. The experiment, however, was ended when the criteria put in place resulted in certain jurisdictions actually having negative numbers, as the environmental harms were calculated as outweighing the GDP benefits.

Yet, until China develops a more holistic legal system that brings stronger coordination between national and local governments, some concept of a green GDP may remain the best hope for ensuring the implementation of

nationwide environmental standards. One suggestion being considered now is tweaking the calculus so that economics and the environment are measured as mutually-achievable goals that are added together, as opposed to competing goals that may cancel each other out when environmental harms meet or exceed the amount of economic growth. However, even this is a hard sell to many local officials who want to retain full discretion to determine how best to balance their regional economic and environmental considerations.

## **Permitting and Enforcement**

While the challenge of implementing national environmental standards at the local level is likely the largest obstacle to a stronger environmental law framework in China, the limited toolbox for local governments to enforce standards on their own is another significant hurdle.

A fundamental pillar of any command and control system is the ability to regulate a party's actions in pursuit of a governmental goal, and to enforce regulations against that party when it fails to comply. In the United States, as a general proposition, this system is implemented through permits largely issued by state and local governments, and the ability to enforce against a polluter who doesn't comply with a permit.

In China, local EPBs similarly take the lead responsibility for issuing permits to parties who discharge into the air and waters. However, the similarities between the U.S. and Chinese permitting systems typically end there. While it is difficult to generalize among different approaches by different EPBs (again, because there is no real national uniformity), many see a permit in China as permission to pollute, rather than a restriction on discharges. Moreover, permits frequently appear to be issued on an ad hoc basis, and fail to take into account various standards to be set for the air or water body as a whole. And once a permit is issued, enforcement against a polluter, in the view of many observers, is virtually nonexistent.

As with the challenges concerning implementing a system of cooperative federalism, discussed above, the hurdles related to China's permitting system are not

limited to the environment. Rather, they encompass larger impediments in a system lacking a well-established rule of law. In the United States, the “stick” for most polluters is the threat that a court may impose significant financial and even criminal penalties for failing to comply with permitting regimes. In China, however, the legal system historically has tended to promote informal resolutions to such disputes. While alternative dispute resolutions clearly can, under the right circumstances, lead to stronger environmental results than litigation in any legal system, China’s jurisprudence lacks significant precedent establishing significant consequences for polluters.

As with efforts to bypass federalism-related weaknesses outlined above, Chinese leaders are working to enhance the enforceability of permits and mechanisms to control pollution. The China Environmental Law Institute at Wuhan University, for example, is working to train judges for China’s first environmental court. In Beijing, lawyers for the Center for Legal Assistance to Pollution Victims are using the tools at their disposal to hold polluters accountable for the specific damage they cause to individuals, farmers, and land. To date, the center has handled approximately eighty cases. Still, in an economy as large and growing as China’s, it will take nationwide authority for local governments to develop the tools they need to significantly address the country’s pollution problems.

## **Public Participation**

Finally, the third issue in implementing an environmental law framework—public participation—stems from the general lack of transparency in China’s legal system. At the same time, this may be the area showing the most rapid progress.

In the United States, the opportunity for public participation has dovetailed with environmental protection since the dawn of environmental law development. In enacting environmental laws, Congress recognized the need for the public to contribute its views toward improving the environment, while also providing for transparency in decision making to ensure the government applies a robust and appropriate analysis.

The general limitations on public participation and transparency in the Chinese legal system lie well outside the scope of this article. Traditionally, however, those well known limitations have also hindered public participation and transparency in environmental issues. Accordingly, public participation has been one of the key areas of focus for those advocating a stronger Chinese environmental law framework.

At the same time, of the three pillars discussed here, public participation is showing the greatest signs of progress. Bie Tao, the deputy director of MEP’s Policy and Legislation Department, whose title roughly translates into the equivalent of the EPA general counsel, has been at the forefront of actively advocating increased public participation in environmental law and rulemaking. Last September, for example, the MEP’s predecessor, SEPA, published a proposed national clean water law in major Chinese newspapers. Public access to the text of the proposal was a relatively dramatic new occurrence in the Chinese legal system.

Even broader in scope, in May 2008, MEP enacted its Measures for the Disclosure of Environmental Information. The stated purpose of the regulations is to provide both for increased transparency and participation by the public for many environmental rulemaking and substantive issues. Significant questions remain about how the regulations will be implemented, whether the exclusions will swallow the rule, and how the government will be accountable for showing that it actually is taking the public’s views into consideration. Yet, these concerns should not distract from the symbolic step forward the public participation regulations represent.

## **Conclusion**

A critical distinction between MEP’s ability to issue its public participation regulations and the challenges it faces in addressing federalism, permitting, and enforcement-related issues, however, is the state of the country’s underlying rule of law. In the case of public participation, the same day that MEP’s regulations went into effect, the State Council, the country’s chief administrative authority, effectuated general regulations on “Open Government Information.” In the instance of

public participation, therefore, the national government provided certain building blocks to environmental regulators, which they could then tailor to the environmental context.

In contrast, regarding federalism, permitting, and enforcement-related challenges, there is at the present time no national solution. Nor—arguably—does any such national solution exist on the horizon. Thus, these problems may remain unresolved until the national government similarly places a priority on developing the building blocks MEP and other regulators can use.

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## ENVIRONMENTAL LAW COOPERATION WITH CHINA

**Steve Wolfson**  
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### China's Severe Environmental Problems

China's environmental crisis increasingly affects the United States and the rest of the world. Pollutants transported from Asia add to U.S. air pollution levels; China recently passed the United States in greenhouse gas (GHG) emissions (though the U.S. level is much higher per capita); and toxics such as lead in toys and other exports pose unnecessary risks in the United States and other markets.

The effects in China are even more severe. The environmental price of China's impressive economic growth has been very high. Many people in rural China lack access to safe drinking water, in part because untreated wastewater and agricultural run-off contribute to China having more organic water pollution than India, Japan, and the United States combined. China leads the world in emissions of sulfur oxides, Chinese air quality standards are rampantly exceeded, and hundreds of thousands die from air pollution each year.

The challenges will increase as goods like automobiles and air conditioning come within reach of more Chinese consumers and China continues to massively expand its cities, industry, highways, and electricity generation (though Chinese officials stress that the oft-cited 500 new coal-fired power plants will supplant antiquated, inefficient, and highly polluting plants they are working to shut down).

China's growing efforts to improve its environmental laws, and their implementation and enforcement, are motivated by concern for the environmental health of their citizens, the desire to be considered a responsible world power, increasing concern among multinationals in China about environmental issues and reputational risk in their supply chains, and the growth in unrest and protests spurred by environmental problems. Finally, Chinese officials are well aware of the high health and economic costs of pollution.

### TRENDS NOW AVAILABLE ONLINE!

Section members are now able to view the newsletter *Trends* in .pdf format in the Section Members Only portion of the Section Web site at [www.abanet.org](http://www.abanet.org). Issues dating back to

September/October 2006 are archived. Section members may also view *The Year in Review* and *Natural Resources & Environment*.

The online versions of the publications contains all the articles found in the paper copies, created in .pdf format.



## China's Evolving Environmental Law Framework

While China has made progress in enacting laws and directives to address air and water pollution, environmental impact assessment (EIA), clean production, renewable energy, and other environmental issues since the 1992 Rio Conference, the system of environmental laws in place today is incomplete in important ways. Recent analyses by Chinese and international experts have identified gaps in cross-cutting areas such as authority, supervision, accountability, monitoring, and enforcement, and also in some sectors such as regulation of toxic chemicals and control of soil pollution.

Some of the legal provisions are vague, more reflective of aspiration than a mandate capable of implementation. Transparency, public participation, and procedures for checks on agency decisions are at early stages of evolution. For example, although public input is required under China's EIA law, officials have held few public hearings; some were held under a loophole that allows "make up" hearings (without penalty) long after construction has begun, and there has been little if any effective judicial review of the EIA public participation process. Chinese officials are working to improve access to information and public participation. (See Allison Moore and Adria Warren, "Legal Advocacy in Environmental Public Participation in China: Raising the Stakes and Strengthening Stakeholders," in Woodrow Wilson Center, *China Environment Series* 2006; Alex Wang, "One Billion Enforcers," in *Environmental Forum* March/April, 2007).

Much of the implementation of environmental law is left to provincial and local Environmental Protection Bureaus (EPBs). The effectiveness of many EPBs is quite limited, as their actions are often driven far more by local economic interests than by local or national environmental objectives (known as "*local protectionism*"). Moreover, Ministry of Environmental Protection (MEP) oversight and local public accountability play minor roles. While the development of new MEP Regional Centers is a positive sign, it is yet not clear whether they will have a sufficiently

trained staff, oversight incentives, or legal authority to affect this problem.

The 2007 Organisation for Economic Cooperation and Development review of China's environmental performance recommended strengthening MEP supervision of local EPBs to effectively implement environmental law and regulations nationwide, including establishing a nationwide permitting system for pollution prevention and control, and expanding the legal basis for, and use of, pollutant trading and other market-based instruments.

Executives of multinational companies complain that the regulatory system allows their factories in China—which they contend meet a high international standard wherever they are located—to be undercut by dirtier local (often publicly-owned) factories. To make matters worse, the multinationals' environmental problems receive far greater attention than similar or worse problems in locally-owned facilities. It is intriguing to hear these executives call for China to strengthen its standards and enforcement to level the playing field.

The Chinese legal system also differs in important ways from the U.S. system, including the absence of a "checks and balances" approach, judicial independence, a supporting framework for public interest litigation, or citizen suit provisions. These differences pose significant hurdles to effective operation of environmental laws, or perhaps suggest that China's path to environmental protection may, at least in some respects, be systematically different.

### Signs of Progress

This is, however, only one side of the coin. There are important signs of progress in Chinese environmental law. The officials I have met leave no doubt that they embrace the need to strengthen the legal framework, increase access to information and public participation, and improve implementation and enforcement.

This year MEP has been elevated to Ministry status and plans to increase the number of staff members by fifty, a 25 percent increase, to improve monitoring and

supervision. Li Jing, *Environment Ministry Adds 2 Departments*, CHINA DAILY (July 11, 2008). Recent amendments to the Water Pollution Control Law provide a basis for stronger enforcement by modestly increasing penalty levels. Implementation of a new law on access to government information, which took effect May 1, 2008, will be closely watched. A spate of recent regulations, circulars, and directives have advanced initiatives to use bank loan policies, export licenses, an SO<sub>2</sub> cap and trade system, publicity campaigns, and improved EIA public participation procedures to bring additional pressure to bear on polluters.

### **EPA Cooperation with China on Environmental Law**

China's openness to international cooperation is another positive sign. As China's contribution to global and trans-boundary pollution has grown, the Environmental Protection Agency (EPA) has broadened its cooperation with China. EPA participates in the cabinet-level Strategic Economic Dialogue, led by Treasury Secretary Henry Paulson. General Counsel Roger Martella inspired and guided the launching of the efforts described below by leading EPA Office of General Counsel (OGC) meetings in China with environmental officials and with Chinese environmental law experts.

OGC is sharing environmental law experience and expertise with China and has created a new Web site to advance understanding of developments in Chinese environmental law, available at [www.epa.gov/ogc](http://www.epa.gov/ogc). In its first three months, users viewed the site over 4,000 times and more than eighty-five organizations asked to receive periodic updates.

OGC also collaborated with the American Bar Association (ABA) in facilitating three training workshops on Environmental Conflict Resolution and is now working to share information on EPA-state relations and other aspects of the operation of U.S. environmental laws in response to requests from MEP. Input and parallel efforts by the ABA and other Chinese environmental law experts, including the authors featured in this newsletter, play an important

role in advancing the ball on these issues. EPA's Office of Enforcement and Compliance Assurance and several EPA Regional Offices are also active in cooperation with China on closely-related projects on environmental compliance and enforcement, EIA, and emergency response. EPA's international office and program offices are also involved in important technical and policy cooperation with China.

The cooperative efforts on environmental law discussed above are only one piece of the puzzle—there are substantial efforts in policy, technical, compliance, and enforcement that also contribute to China's efforts to strengthen environmental protection. This environmental law cooperation, often conducted in close collaboration with these other efforts, is designed to contribute to ensuring China has the legal framework and implementation tools to meet its environmental challenges, which will benefit China, the United States, and the world.

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## **ENVIRONMENTAL PROTECTION AND LABOR SAFETY IN CHINA: THE REGULATORY FRAMEWORK AND APPROACHES TO DUE DILIGENCE**

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**Richard A. Steinwurtzel, Liang Tsui,  
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The algae blooms on Lake Taihu in 2007 that cut off drinking water for several of China's wealthiest cities and the many explosions and collapses at China's coal mines are symbolic of the challenges that the People's Republic of China (PRC) faces in environmental protection and labor safety, respectively. For nearly thirty years, economic development has been the top priority of China's leaders, but faced with environmental, labor, and other social welfare concerns, the PRC leadership in the last few years has adopted as its goal the building of a "harmonious society"—which means bringing improvements to environmental and labor protections and social welfare without unduly compromising economic growth. The new Labor Contract Law (effective in January 2008) and the elevation of the State Environmental Protection Administration (SEPA) to ministry status as the Ministry of Environmental Protection (MEP) in March 2008 both show Beijing's seriousness with respect to its "harmonious society" policy. Most recently, Beijing's massive measures to improve the air quality of Beijing during the 2008 Olympics, including closing certain polluting factories, severely restricting vehicular traffic, and suspending construction projects, amply demonstrate the scale and speed at which Beijing is able to act.

Decentralization, local interests, and other facts on the ground will continue to shape implementation, but the clear trend is towards greater protection for the environment and labor safety (as well as other labor protections). They are therefore areas foreign interested parties should carefully consider when making a new investment or evaluating ongoing China operations. To assist in that regard, this article sets out the regulatory framework and approaches to due diligence for environmental and labor safety law in the PRC.

## **REGULATORY FRAMEWORK**

Over the last thirty years, China has put in place the laws and regulations necessary to govern a modern economy. Of late, laws and regulations governing environmental protection and labor safety have become increasingly complex. Greater sophistication is also evident in disclosure regimes applicable to publicly-listed companies, including financial statement disclosure. Set out below are key areas of regulation and required disclosure applicable nationally. Localities, particularly Beijing, Shanghai, and Guangdong, may have additional regulatory requirements in these areas.

### **Environmental Law**

#### ***Pollution Standards and Permits***

The principal means through which the PRC government regulates environmental protection is through a series of standards and permit regimes. The Environmental Protection Law, the Air Pollution Prevention Law, the Water Pollution Prevention Law, the Marine Environmental Prevention Law, the Noise Pollution Prevention Law, and the Solid Waste Prevention Law operate together to set air, water, soil and noise pollution standards as well as to require permits for companies that generate or emit pollutants. National standards are set by the central government, while the issuance of permits generally occurs at the local level. Local governments may require stricter standards than national standards but may not allow lesser standards. Enforcement may be initiated by the local or national authorities.

A company that seeks to discharge or emit regulated pollutants is required to register with MEP. The company is obligated to disclose which pollutants it seeks to emit under normal operating conditions, the facilities it will use to treat pollution, and associated technical data concerning the prevention and control of such pollution. If the discharge is made within the relevant standard, a pollution tariff is applicable to any air or water discharge (not solid waste).

MEP is empowered to enforce the standards and permit regimes through warnings, fines, orders to

suspend operations, orders to install (or use) pollutant treatment facilities, or even orders to close the business of a violator. A company may also be held civilly liable in private court actions for injuries caused by its pollution. If a violation causes a serious environmental accident, the responsible person may face criminal charges. As evidenced by the seventeen indictments (three of which led to life imprisonment terms) arising from the Shan Xi Hong Dong mine explosion which involved 105 deaths, enforcement, including criminal enforcement, is on the rise.

### ***Environmental Impact Reports***

The principal other means through which the PRC government seeks to limit environmental harm is through a requirement under the Environmental Protection Law and the Environmental Impact Valuation Law that an environmental impact report be prepared for and approved by relevant levels of MEP prior to certain construction projects. Typically, the approval is granted by the local offices of MEP, though multi-provincial, military, and certain other projects are handled solely within the national MEP office. A developer is required to produce an environmental impact report, an environmental impact form, or an environmental statement depending on the significance of environmental impact. A detailed report is required to be prepared and approved if the project is likely to have a “significant impact on the environment.” In these cases, consultation with affected businesses and the public through a hearing or other forums is also required, and the report should include suggestions from the public consultation process that were adopted as well as those that were not adopted and an accompanying explanation. If the project is likely to have only a “minor impact on the environment,” a brief statement to that effect is satisfactory.

### ***Clean Production and Recycling***

Several new regulations have increased control of which materials can go into certain products and how those products are handled once their useful lives have passed. These regulations supplement product standards already in effect under the Product Quality Law and relevant regulations. In particular, the Clean

Production Development Law provides certain guidelines for clean production, including requirements that manufacturers use environmentally sound raw materials and equipment, and collect and recycle waste.

A draft Recycling Economy Law is presently under consideration in the National People’s Congress, the principles of which are the reduction of pollutants and the reuse of materials. The proposed legislation aims to use economic incentives as well as administrative techniques to achieve its goal, and tax and financial benefits are provided to companies that meet certain guidelines. In addition, regulations already mandate the reduction and recycling of components in several industries, including the electrical and electronic products and automobile industries.

### ***Pollution Liability***

The PRC government is in the trial stage of implementing a program mandating that companies in the chemical, dangerous waste disposal, and certain other industries carry liability insurance for damage to third parties as a result of an environmental accident. In addition, policy makers reportedly are discussing the adoption of a pollution liability regime modeled on the U.S. “Superfund” program.

### ***Green Initiatives***

The central government has begun to make environmental compliance relevant to the receipt of several other regulatory benefits.

Environmental review for public companies. As of 2008, the China Securities Regulatory Commission (CSRC) requires PRC companies that are or seek to be listed in the PRC (and, possibly, overseas) and that are in designated heavily polluting industries to provide the CSRC with a report from MEP on the company’s environmental compliance record. The CSRC will take into account the MEP report when considering whether to grant listing or other requisite approvals.

Environmental review for bank loans. In 2007, SEPA, the People’s Bank of China, and the China Banking

Regulatory Commission (CBRC) jointly promulgated a directive making bank credit contingent on environmental compliance. Under the directive, banks are encouraged to set policies making credit available only to companies that are in compliance with environmental regulations. SEPA and CBRC established an information sharing platform allowing banks more accurately to evaluate companies seeking credit.

Environmental tax and customs policies. In 2007, PRC tax and customs authorities adjusted certain tax and customs policies with an eye towards improved environmental protection. The authorities increased the export tax on products from certain heavily polluting and “high energy consumption” sectors, and a tax rebate given to exporters was eliminated for many heavily polluting or high energy consumption sectors. In addition, the resource tax on various ores used in heavily polluting or high energy consumption industries was increased. Further adjustments of this nature are expected.

### ***Climate Change Initiatives***

China participates in the United Nations Framework Convention on Climate Change and, as a developing country, is a signatory to the Kyoto Protocol. Under these agreements, developed countries can buy Certified Emission Reduction credits from developing countries, which credits are derived from Clean Development Mechanism (CDM) projects. China’s CDM program is regulated by the National Development and Reform Commission. China has no reduction commitment under the Kyoto Protocol. China, however, is required to formulate cost-effective national and regional programs under the Kyoto Protocol to improve the quality of local emission factors, activity data, and/or models. China, in addition, is obligated to formulate, implement, publish, and regularly update national and regional programs containing measures to mitigate climate change and measures to facilitate adequate adaptation to climate change.

Separately, in 2007, the national government issued a National Plan for Responding to Climate Change,

which sets out general policy priorities for the control and decrease of carbon pollutants and adaptation to climate change. The issue of climate change is expected to be the focus of continued regulatory interest.

### ***China’s RoHS***

In 2006, MEP and five other PRC government agencies approved the Electronic Product Pollution Control Directive (EPPCD), which requires a manufacturer to eliminate or restrict hazardous materials from its products. EPPCD applies to electronic information products, which cover electronic radars, semiconductor, broadcast and TV products, computers, consumer electronics, electrical testing equipment, electrical components, small electronic appliances, and electrical materials. The manufacturer is required to eliminate or restrict hazardous materials in its business operations in accordance with the EPPCD’s hazardous materials control standard, and mark and disclose the presence of certain hazardous substances on a product’s packaging or specification of a product’s contents. In addition, under EPPCD, a distributor is prohibited from selling electronic products in violation of the EPPCD’s hazardous materials control standard.

### ***Labor Safety Law***

#### ***Production Safety Standards and Permits***

The Production Safety Law implements a series of standards and permits relating to production safety. Companies are required to implement general standards as well as industry-specific standards and are required to undertake various production safety measures, including the installation of prominent warning signs on dangerous sites, facilities, and equipment. Companies in the construction, mining, dangerous chemical, and certain other industries are also required to obtain production safety permits from the State Administration of Work Safety before commencing operations. The law, moreover, establishes employer liability for production safety violations.

## **Labor Contracts**

An important recent development in labor safety is the requirement under the new Labor Contract Law, in effect since January 2008, that an employer and employee must sign a labor contract that includes disclosures regarding, among other things, the scope of work to be performed, working conditions, the place of work, occupational hazards, and work safety measures. The Labor Contract Law, in addition, prohibits an employer from terminating an employee's labor contract in two circumstances connected to work injury: (i) if the employee was engaged in operations that exposed him or her to an occupational disease or hazard and had not undergone a pre-departure occupational health examination; (ii) if the employee is suspected of having contracted an occupational illness and is being diagnosed or undergoing medical observation.

If the employee contracts an occupational illness or sustains a work-related injury and has lost all or part of the capacity to work, the employee's disability must be verified by the Labor Capability Verification Committee as a condition precedent to the receipt of disability compensation. After the employee's illness or injury is verified at one or more prescribed levels, the employee is entitled to disability compensation on a lump sum basis from the work injury insurance fund (part of social security system) and the employer is required to pay the social security insurance for the employee whether or not the employee works. The employee also will be entitled to receive monthly compensation either from the work injury insurance fund or from the employer depending on the level of disability.

An employer can be subject to administrative penalties as well as civil and criminal liability for labor law violations. For a civil dispute, including a dispute over a labor contract, the parties are required to take the matter to the relevant labor bureau for mediation or arbitration. The bureau's decision may be appealed to a court of law.

## **Occupational Injury Prevention**

Under the Occupational Disease Prevention Regulation, if a new project to be constructed is likely to be one where a risk of occupational injury is present, an occupational injury risk assessment report is required to be submitted to the local health bureau for approval before construction begins. The regulation also requires an employer to disclose occupational injury risks to employees and provide training and physical checkups to minimize the risk and effect of incurring occupational injuries.

## **Occupational Injury Compensation**

The Occupational Injury Insurance Regulation requires an employer to purchase occupational injury insurance for its employees. If an employer fails to provide insurance, and if an employee is injured on the job, the employee can recover against the employer in tort.

## **Disclosure under the Hong Kong Stock Exchange (HKSE) Listing Rules**

While the HKSE listing rules generally do not make specific reference to required disclosures for environmental or labor safety in an initial public offering (natural resources exploration and production companies excepted), the overarching rule requiring disclosure of material information in the prospectus will cover material environmental and labor safety information. The HKSE seeks to ensure that sufficient material information regarding environmental protection and labor safety is disclosed, including, among other things, descriptions of the rules and regulations applicable to the company, any incidents of noncompliance, the attainment of requisite permits and approvals, specific measures taken to comply with the relevant rules and regulations, and any potential future risks with regards to these areas. Furthermore, for post-listing compliance, listed issuers are encouraged to disclose in the management discussion and analysis sections of their interim and annual reports information on the listed issuer's environmental policies and performance, including ongoing compliance with relevant laws and regulations.

## Financial Statement Disclosure

Complete and accurate financial statement disclosure forms an important part of environmental and labor safety disclosure. The most commonly encountered issue is when and how to disclose contingent liabilities. Hong Kong Accounting Standard 37, International Accounting Standard 37, and PRC Accounting Standard 13 each adopt a similar standard with regard to an issuer's obligation to make financial statement provision for, and to disclose, contingent liabilities. Under these standards, a provision is recognized when (i) an entity has a present obligation as a result of a past event, (ii) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and (iii) a reliable estimate can be made of the amount of the obligation. An outflow of resources or other event is regarded as probable if the event is more likely than not to occur, i.e., the probability that the event will occur is greater than the probability that it will not. The measurement used is the best estimate of the expenditure required to settle the present obligation at the balance sheet date—that is, the amount that it would rationally pay to settle the obligation or transfer it to a third party at that time. Contingent liabilities, which are not yet recognized as liabilities on a balance sheet, are to be disclosed in the notes to the financial statements unless the possibility of an outflow of resources embodying economic benefits is “remote” (an undefined term under the applicable International Accounting Standard that requires the application of a materiality concept).

## ENVIRONMENTAL AND LABOR SAFETY DUE DILIGENCE

The expansion of the PRC regulatory framework for environmental protection and labor safety means that heightened consideration should be given to these issues when investing in China. The principal means for a foreign investor to evaluate the environmental and labor safety record of any investment target is the due diligence process. Due diligence, properly done, will identify potential problems and, in combination with legal and in some circumstances further technical analyses, allow an investor to make an informed decision regarding whether and how to invest. Set out

below are some practical steps that should be taken as a part of the due diligence process, followed by several sample due diligence information requests.

## General Due Diligence Steps

### ***1. Tailor the Approach to Fit the Nature of the Transaction***

Every transaction is different, and the due diligence approach depends on many factors. The most obvious factor is the nature of business of the company that is being reviewed. This factor will determine the questions to be asked, the depth of the review, and the extent of necessary follow-on legal and technical analyses. Naturally, greater attention should be paid to environmental compliance for companies heavily involved in the use or generation of hazardous materials. Those companies involved in hazardous methods of production, moreover, require greater labor safety due diligence.

The type of transaction itself may also affect the due diligence approach. With respect to securities offerings, the approach to due diligence must be designed to ensure compliance with all applicable securities disclosure requirements. Merger and acquisition transactions or private equity investing are different, and the due diligence needed will depend on the information that the acquirer or investor requires to make a decision, balanced by the time and cost the acquirer or investor is willing to incur and the degree of risk the acquirer or investor is willing to accept. The 100 percent acquisition of a company by a listed acquirer could require a different diligence approach than a small minority investment by a private party. In sum, due diligence should be carefully planned.

### ***2. Request and Review Documentary Information***

A due diligence information request list should contain both general and tailored requests. Attention should be paid to the varying regulatory requirements applicable to different industries and different locations. As companies may themselves not entirely understand their regulatory obligations, it often falls to the advisers

to inform them of what is required. In all cases, certain basic information will need to be reviewed, such as permits and approvals necessary to operate. Several sample information requests are set out below. In particular, the following should be obtained:

- Environmental and labor safety licenses, permits and approvals, including land use rights certificates, pollutant discharge permits, production safety permits, and construction permits;
- Environmental impact reports and occupational injury risk assessment reports (and related approvals), environmental and labor safety audit reports, and environmental site assessments (including the results of any sampling);
- Labor contracts, material contracts relating to environmental and labor safety matters, and merger and acquisition agreements;
- Environmental and labor safety insurance policies; and
- Claims, notices of violations, and administrative penalties for environmental and labor safety matters.

In addition, audited financial statements and the related footnotes, if available, need to be closely reviewed from the environmental perspective.

### **3. Conduct On-site Visits and Telephone or In-person Interviews**

Documentary review is only one part of the due diligence process. On-site visits and in-person and telephonic interviews are essential to understanding a company's operations, particularly from an environmental and labor safety compliance perspective. Direct personal experience at a company can be helpful in evaluating how seriously the company takes environmental and labor safety compliance. Interviews can bring out points of concern not otherwise evident and highlight areas where further documentary review and legal or technical analysis may be necessary. On-site visits should be made of the company's principal operating sites, and interviews should be conducted with the following persons:

- Senior management responsible for environmental and labor safety matters,

including the director of human resources and in-house counsel;

- The chief financial officer and, in some cases, the company's outside accountants (with respect to contingent liability issues);
- Managers at specific facilities and their lead environmental and labor safety compliance officers (depending on the depth of the review);
- Outside counsel (for any potentially material environmental and labor safety legal proceedings); and
- Outside consultants (for any potentially material environmental and labor safety investigations/remedies).

### **4. Retain Expert Consultants to Conduct Site Assessments, If Necessary**

Parties generally do not retain separate expert consultants to review environmental or labor safety compliance. In some cases, however, where complicated technical issues are present or where environmental or labor safety compliance is of particular importance, such as the acquisition of a company in an environmentally sensitive business, seeking outside expert analysis is prudent.

### **5. Obtain a PRC Legal Opinion**

A PRC legal opinion forms an important part of the due diligence record of both stock offerings and merger and acquisition or private equity investment transactions involving a PRC business. For Hong Kong listings, the HKSE requires a PRC legal opinion covering the proposed issuer's compliance with all applicable PRC laws and regulations, including environmental protection and labor safety laws and regulations. As the opinion is required by the HKSE to list out, among other things, the details of the licenses, permits, or certificates obtained by the issuer, the PRC legal opinion generally takes a form similar to that of a due diligence report rather than to that of a customary securities opinion. For U.S. or U.K. listings, a PRC legal opinion, in a more customary securities opinion form, is a useful part of the due diligence record. For merger and acquisition transactions or private equity investments, the acquirer or investor may request the

company to procure a PRC legal opinion with respect to the legality and enforcement of agreements in the PRC and with respect to compliance with the law in the PRC.

## **6. Consult with Government Authorities in Special Cases**

In certain industries where environmental or labor safety problems have been especially prominent, seeking guidance and understanding from relevant government authorities may be prudent prior to proceeding with a transaction.

## **7. Continue Due Diligence throughout the Transaction**

Due diligence is a process that continues from the beginning of a transaction to its completion. It is important to keep track of documents that have yet to be provided and follow-up at appropriate times. “Bring-down” due diligence interviews should occur at various stages of a transaction to ensure that no adverse material change has suddenly occurred or developed. For some transactions, an acquirer or investor will obtain a due diligence report. From time to time, an acquirer or investor may propose, at one or more interim stages, to move forward without complete information. In those cases, careful evaluation should be made of the risks involved and the benefit that additional due diligence steps will provide. In the acquisition context, careful contract negotiations over representations and warranties (and related disclosure schedules) serve as an excellent due diligence mechanism. For example, a comprehensive set of environmental representations will often require a seller to provide correspondingly detailed disclosure schedules. Sellers often delay, or fail to provide, such disclosure schedules until the late stages of a transaction, and such schedules must be reviewed carefully to ensure that no new issues are being disclosed for the first time.

### **Information Requests for Due Diligence**

Presented below are sample requests that target information which is helpful in understanding the

environmental and labor safety condition of a PRC company.

### **Properties**

Sample Request: Please identify and describe all real property or other facilities owned, operated or leased, either directly or indirectly (*i.e.*, through subsidiaries, joint ventures, operating units, or other related entities) and provide all relevant land use rights certificates, building ownership certificates, and construction permits.

### **Environmental and Labor Safety Management**

Sample Request: Please identify and describe (i) individuals currently responsible for environmental and labor safety compliance; (ii) environmental and labor safety compliance programs and practices; and (iii) current pollution prevention, control, or countermeasure plans and emergency response plans. Indicate whether any facilities have achieved ISO 14001 certification.

### **Environmental and Labor Safety Permits**

Sample Request: Please provide copies of all environmental and labor safety permits, waivers, exemptions, exclusions, variances, warnings, notices of violation, fines, communications with regulatory authorities regarding compliance with any such environmental or labor safety permits, and any proposed or pending applications for issuance or renewal of any environmental and labor safety permits.

### **Environmental and Labor Safety Reports, Audits, and Inspections**

Sample Request: Please provide copies of (i) all environmental impact reports and occupational injury risk assessment reports and related government approvals; (ii) all other environmental and labor safety audits, action plans, reports, impact statements, tests, site investigations or assessments, whether performed internally or by an outside consultant; (iii) reports or other documents relating to any inspection by any

governmental entity concerning compliance with environmental and labor safety laws, regulations, and permits; (iv) material safety data sheets and studies concerning health effects upon employees in connection with occupational exposure to any substances; and (v) notices or filings pursuant to any environmental and labor safety laws, regulations, and permits. In addition, to the extent known, identify any conditions or events that might give rise to environmental or labor safety liabilities.

### ***Claims, Information Requests, and Notices of Violation***

Sample Request: Please provide copies of all administrative or judicial orders, injunctions, notices, records of decision, claims, complaints or correspondence discussing actual or potential liabilities, requests for information, citations or notices of violation relating in any way to environmental or labor safety matters (including claims for cleanup costs, fines or penalties, property damage and/or personal injury, and notices of liability or potentially responsible party).

### ***Climate Change***

Sample Request: Please provide copies of all studies, capital expenditure plans, and other programs proposed or being considered by or on behalf of the company relating to the impact of climate change on the business, including any calculation of emissions inventories and any calculation of the potential costs (and/or opportunities) associated with reducing greenhouse gas emissions, such as installation of pollution control equipment, operational changes, and the purchase and/or sale of carbon offset credits. If a CDM or other emissions trading programs has been implemented, please provide any applications and government approvals relating thereto.

### ***Labor Contracts***

Sample Request: Please also provide (i) copies of labor contracts for each category of employee where labor safety provisions differ, and (ii) a written description or organizational chart delineating the categories of employees engaged in hazardous activities.

### ***Agreements***

Sample Request: Please provide copies of any contractual indemnity, allocation, or other cost-sharing provisions relating to environmental or labor safety liabilities, including all such provisions contained in any acquisition, sale or merger agreement, or in any separate letter agreement or other documents.

### ***Audit Letters***

Sample Request: Please provide copies of all letters or other documents prepared internally or by any legal counsel or other experts in response to inquiries by any auditors reflecting any information relating in any way to environmental or labor safety matters.

### ***Capital Expenditures and Asset Retirement Obligations (AROs)***

Sample Request: Please provide copies of all budgets, proposed capital projects, and other estimates of capital costs and other expenditures for environmental and labor safety matters, including AROs.

### ***Insurance***

Sample Request: Please provide copies of all insurance policies and claims, notices or other communications with insurance carriers relating to environmental or labor safety liabilities, including documents relating to occupational injury insurance claims and amounts paid to employees pursuant to such claims or pursuant to other actions alleging personal injury.

### ***Financial Reserves***

Sample Request: Please provide information regarding any financial reserves in connection with environmental or labor safety matters, and a complete breakdown of any such reserves.

## **CHALLENGES GOING FORWARD**

The establishment of regulatory regimes governing environmental protection and labor safety in the PRC has proceeded of late at a quickened pace, and all signs point to its continued emphasis by the central

government. The landscape of laws and regulations enacted is increasingly comprehensive, but for the foreseeable future, implementation and enforcement gaps will remain. The elevation of SEPA to ministry status reflects the central government's desire to strengthen environmental protection, and the new Labor Contract Law manifests the central government's desire to provide additional protection to workers.

Notwithstanding the heightened interest in these areas by the central government, local governments continue to manage the local offices of the environment protection and labor bureaus, and one can realistically expect a great degree of decentralization to continue. Given the priority that local governments—for a variety of reasons—generally place on economic growth, local interests are likely to continue to lead to uneven enforcement of environmental and labor safety rules. This fact of life can pose a challenge to an acquirer or investor which seeks to evaluate the target company's compliance with local and national regulations.

Despite these challenges, it is clear that the overall policy direction is towards increased environmental protection and work place safety, as both are key policies underlying the PRC leadership's goal of building a "harmonious society." Accordingly, these areas have become more significant and will likely be subject to additional regulatory focus. Foreign interested parties would be prudent to increase scrutiny of these areas prior to an investment and to maintain continued oversight after the transaction is closed. Thoughtful and substantively thorough due diligence should be the norm, and contractual protection should be emphasized. Opportunities abound in China, but to succeed in the long term, careful planning and capable execution are essential in avoiding costly or crippling environmental or labor safety issues.

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## THE ENVIRONMENTAL IMPACT ASSESSMENT IN CHINA: THE FIRST STEP TOWARD COMPLIANT OPERATIONS

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Environmental impact assessments (EIAs) are required for *all* projects in China involving any construction. Anyone building (or modifying or renovating) a warehouse, an R&D facility, commercial office space, a manufacturing facility, a restaurant, or a new housing development, needs to prepare an EIA. The broad scope of China's EIA law surprises some American companies entering the China market; however, its comprehensive nature actually streamlines the environmental approval process when compared to the hodgepodge initial permitting structures of many U.S. states.

EIAs are governed in China by the Environmental Impact Assessment Law (effective Sept. 1, 2003) (the "Law"), which builds upon pre-existing EIA regulations and references to EIAs in several other environmental laws. Although the Law has wide application, it makes distinctions and tailors its requirements depending on the nature of the project.

### What type of EIA is required?

The Law provides for three levels of EIA filing requirements based on the anticipated scale and environmental impacts of a project (Major, Light, or De minimis). When assessing impacts, both the construction and operational phases of a project are considered.

An *Environmental Impact Registration* (EIR) may be filed for those projects whose impact on the environment is predicted to be de minimis. The Ministry of Environmental Protection (MEP) has developed a fairly simple EIR form, which may be completed by the project owner.

An *Environmental Impact Assessment Form* (EIA Form) may be completed for those projects with only

a “light” projected impact upon the environment. The MEP form in this case requires a relatively brief “analysis or special evaluation” of the project’s environmental impact. Unlike the EIR, however, this form must be completed by a qualified EIA consultant (more on these below).

A full *Environmental Impact Assessment Report* (EIA Report) is required for those projects whose construction and/or operation will have a “major” impact upon the environment. There are no standardized forms for EIR Reports, they must be completed by qualified EIA auditors, and they must include a comprehensive assessment of the project’s environmental impact. Since EIA Reports are by far the most demanding of the three EIA types, this article will focus primarily on the requirements specific to them (unless otherwise noted).

MEP has developed a Catalogue which provides guidance on how to determine the environmental impact of projects and provides a list of typical projects and their presumed impact. The decision as to which EIA filing is required will be based on a review of the MEP Catalogue and/or the scale of the project, the extent of its pollutant discharges, and the nature of the development site (is it in a drinking water source area, for instance).

Basically, a modest-sized project in the service or light-manufacturing sector (which does not involve significant solid waste generation, air emissions, or water discharges) will probably only require the filing of an EIR or EIA Form. Large construction projects and the construction of any heavy manufacturing facility or chemical plant will almost certainly require the preparation and filing of an EIA Report. Project owners will be aided in the decision as to which type of EIA to prepare by their EIA consultant, and the decision is subject to review by the agency charged with reviewing the EIA submissions.

### **Who may conduct an EIA Report?**

EIA Reports (and EIA Forms) must be completed by qualified EIA consultants. There are two qualification levels for consultants—A (the highest) and B

licenses—based on the prior experience and size of the consultant. Those holding B licenses may complete EIA Reports, which can be approved by provincial-level (or below) Environmental Protection Bureau (EPB) authorities. A consultant holding an A license is required if the EIA needs to be approved at the national level (by MEP).

MEP maintains a list of licensed firms that are, for the most part, local Chinese entities. If a project is to be located in an official “industrial park,” the park authorities will generally have “recommendations” as to which firm should be used, and local EPBs may also “recommend” consultants. These “recommendations” may appear hard to reject, although the ultimate selection decision, by law, is left to the project owner.

Usually a company will want to make sure it has qualified bilingual staff to communicate with the EIA consultant team. Some U.S. entities hire the China office of a U.S.- or Western-based engineering or environmental consulting firm to aid in their interaction with the EIA consultant.

### **How is the EIA conducted?**

In theory, government entities will have conducted a regional or “special program” EIA in most industrialized areas of the country. These EIAs are intended to support regional development plans or local zoning decisions, such as the creation of industrial parks. If completed, such an EIA can simplify the performance of project EIAs; although the environmental impact of the project must still be specifically analyzed, the baseline environmental conditions set forth in the regional or “special purpose” EIA may be used. The farther you get from the coast or major cities, however, the less likely it is that such government-planning EIAs have been conducted.

Indeed, in less developed regions in China there may be a gap between law and practice on many environmental issues, including the EIA. Local regulators may not be familiar with or not in the habit of enforcing the full suite of EIA requirements. Nevertheless, it is in a project owner’s best interest not to simply be reactive, but rather to proactively comply

with all legal requirements (whether enforced locally or not). Current local regulators may be replaced by more zealous ones or national or regional regulators may audit local EIA approvals.

There are rules and guidance documents that generally govern how EIAs are to be performed, and several industry specific guidelines have been developed, e.g., Technical Guidelines for Environmental Impact Assessments: Petrochemical Construction Projects (HJ/T 89 – 2003).

An EIA Outline can be prepared and submitted to the approval authority prior to the preparation of the full EIA. Such outlines are recommended, especially in large projects since they may flag issues that will require special attention, or other items that are better to catch at the preliminary stage rather than at the end of the process. There are no mandatory components of an EIA Outline, but it should generally define the project, and provide a description of the production process (identifying inputs and outputs), anticipated environmental impacts, and pollution control options.

The extent to which the production process needs to be described often generates the most “tension” in the EIA preparation process. In many cases, a process or components of the process may be proprietary. The project owner may simply want to identify the inputs and outputs to the production process, without describing the process itself—a “black box” scenario. The EIA consultant may insist on being provided with a detailed description of the entire process. The Law does not require such details, but the EIA consultant may believe it must have them to adequately perform its job. Acceptable compromises usually are achieved.

The EIA itself will generally deal with the same items as the Outline (although in more depth), but should also include a Clean Production analysis (this involves a review of the production process to determine if the same product can be made with fewer resources and the generation of fewer wastes) and a risk assessment (especially if the project involves the use, transportation, and storage of hazardous substances).

The basic EIA process involves reviewing the preliminary construction plans and engineering analysis

of the project to identify all of its potential impacts (both during its construction and operational phases) on the baseline environment. Local EPBs will often require the purchase of local environmental monitoring data compiled by the local Environmental Monitoring Service (which is often a sub-unit of the EPB) to establish the official baseline for the EIA. The EIA generally considers only *off-site* impacts to human health; the impact of the project on the health and safety of *on-site* employees is governed by other laws and regulations.

Once the environmental impacts are identified, they are compared to national and local environmental standards, and the mass load limits for certain pollutants (usually SO<sub>2</sub> and chemical oxygen demand), which in many cases will be allocated to the project by local regulators (and may actually require more stringent controls than the generally applicable discharge standards). Other key parameters of concern can include the energy efficiency of the project and, particularly in the north of China, its total water use and water use efficiency rates. If the predicted impacts exceed the applicable national or local standards, the EIA must propose mitigation measures.

The Law and regulations require that the public be consulted during the course of the EIA. In most instances this will take the form of public surveys or questionnaires that the EIA consultant will distribute to potentially affected neighbors. The EIA Report must contain the results of the surveys and any comments received along with the owner’s reaction to the comment, i.e., is the comment accepted or rejected and why. Even without these requirements, it is a good idea to engage the neighbors in the planning process to defuse any potential issues at an early stage. It is also possible that during the regulatory review process of the EIA, the reviewing agency may decide to hold public hearings, especially if the project is a controversial one.

### **When is the EIA conducted?**

The EIA is one of the first items prepared in the long list of documents and forms that must be submitted to obtain approval of a project in China. The EIA Report and EIA Approval constitute a part of the Project

Application Report (PAR), which must be filed with and be approved by the National Development and Reform Commission (or its local bureaus) before any foreign invested project can be undertaken.

### **Who approves the EIA Report?**

As noted above, some EIAs need to be approved at the national level, which means by the headquarters office of MEP. MEP approval of the EIA is required for all projects:

- with an investment of US\$100 million or more (or US\$50 million or more for foreign invested projects in the “restricted” category of the Foreign Investment Guidance Catalogue),
- involving construction projects of a “special nature” such as nuclear power facilities, or
- with cross-provincial impacts.

Provincial-level governments may approve all other EIAs, and they may delegate approval authority to sub-provincial authorities.

The EIA review process is supposed to last no longer than 60 days from submission of the completed EIA to the reviewing agency decision, but the reviewing agency can extend these dates if it decides to convene a panel of experts to review the EIA (expert panels can also be convened to review EIA Outlines) or seeks additional public comment. The review period for EIA Forms is 30 days and 15 days for EIRs. Approved EIAs are issued EIA Approval certificates.

Disapproved EIAs will need to be revised pursuant to agency comments. Ultimately, if an EIA is formally and finally disapproved, an appeal process is available but given the deference accorded agency decisions in China, the likelihood of success in such an appeal is extremely low.

### **What happens when construction is complete?**

Once the EIA is approved, the project needs to be constructed in accordance with the basic designs set forth in the EIA, and the pollution control equipment and processes required for the mitigation of identified

impacts need to be constructed and placed into operation at the same time as the balance of the project.

Once the project is completed (and sometime during the 3-month trial operation period required of all polluting entities that have installed pollution control equipment), the project developer needs to apply for an inspection of the environmental control facilities; this inspection will determine if the facilities are the same as those proposed in the EIA and are mitigating the adverse impacts (as evidenced by monitoring data) as predicted in the EIA. A project can not be placed into full operation until it passes this inspection.

If the actual environmental impact of the construction or operation of the project is “inconsistent” with the approved EIA documents, the project owner may be required to undertake additional remediation or treatment measures.

If major changes in the project’s scale, location, production techniques, or pollution control measures or techniques occur after the approval of the EIA, the filing of a “new document” evaluating the environmental impacts of the project in light of the change(s) should be submitted for examination and approval. Some change in the project will inevitably occur because the EIA must be prepared at such a preliminary stage of the project planning process. A project owner should maintain contact with the EIA consultant during the construction phase to obtain guidance as to whether construction changes require additional EIA-related filings. The types of changes which trigger the need for additional filings are not well-defined, and essentially are left to the discretion of the reviewing agency.

Although the penalties for operating without an approved EIA are rather low (maximum penalty of 200,000 Renminbi—approximately US\$28,600), in particularly high profile cases, MEP has ordered facilities without approved EIAs to shut down. The absence of a project EIA for an existing project may also limit access to credit or financing for future projects.

## Next steps in the environmental compliance process?

Within a month after the final inspection, the project owner should register the pollutants discharged from the project with the appropriate EPB. Annual registrations are required thereafter. If any pollutant (including noise) is discharged in excess of the applicable control standard, the owner must explain why this exceedance occurred and set forth a plan for correcting the problem.

The project owner must also apply for permits to discharge air and water pollutants. As part of the permit issuance process the relevant EPB will calculate discharge fees for all discharges below the applicable standards and “over-standard fees” for those discharges in excess of applicable standards. Usually where discharges in excess of standards exist, there must be a plan or time frame by which discharges will be reduced to the level of the regulatory limit. Discharge permits carry terms from 3 to 5 years and are renewable.

## Conclusion

A properly-conducted EIA can set a project on a good footing with the local environmental regulators and provide a good start to environmentally-compliant operations.

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## CHINA'S NEW MEASURES ON OPEN ENVIRONMENTAL INFORMATION: A CLINICAL VIEW

**Carlos Da Rosa**  
**EPA**

## Introduction

On April 11, 2007, China's State Environmental Protection Administration (SEPA) enacted “Trial Measures on Open Environmental Information” (OEI Measures), becoming the first Chinese administrative agency to implement the country's landmark “Regulations of the People's Republic of China on Open Government Information” (OGI Regulations), adopted by the State Council, China's top executive authority. The OGI Regulations constitute China's first nationwide law establishing the principle of disclosure of record information, building upon smaller-scale information disclosure laws adopted by major Chinese cities such as Guangzhou and Shanghai.

By issuing the OEI Measures only a few days after adoption of the OGI Regulations, SEPA (elevated to ministry status in March 2008 as the Ministry of Environmental Protection (MEP)) demonstrated its initiative in seeking to alter entrenched practices of secrecy and non-disclosure in China's bureaucracy. Adoption of the OEI Measures evinces a serious attempt to address China's record of secrecy in handling environmental disasters, such as the benzene spill into northeast China's Songhua River in 2005, which attracted unfavorable worldwide attention. The OEI Measures have just entered into force (May 1, 2008), the same date as the national level OGI Regulations.

In the following sections, the author highlights some distinctive features of the OEI Measures. As discussed below, the author will reflect on the OEI Measures and other related legal developments in light of his experience conducting an environmental law clinic at Guangzhou's Sun Yat-sen University Law School (SYULS) in 2004-2005.

## OEI Measures

Directly reflecting the principles of the OGI Regulations (which bear the unmistakable influence of the U.S. Freedom of Information Act), the OEI Measures require environmental protection departments (EPDs), from the county level and above, to release specified governmental environmental information (Art. 10). The OEI Measures also allow persons, subject to certain exceptions, to request environmental information from EPDs (Art. 5). As the OEI Measures make clear, the obligation to disclose applies not to all information but rather records. Article 2 of the OEI Measures defines “government environmental information” as “information created or obtained by [EPDs] in the course of carrying out their environmental protection responsibilities and recorded and stored in a definite form.”

The OEI Measures’ Article 11 identifies categories of environmental information that EPDs must release on their own initiative. Among these are laws, regulations, rules, plans, and standards; environmental quality conditions and environmental statistics; the “review of environmental impact assessment documentation for a construction project”; environmental administrative lawsuits, penalties, and reconsideration actions; and letters, calls, and complaints from the public about environmental pollution. In addition, the OEI Measures require EPDs to release the names of “bad actor” companies responsible for “serious pollution” that have released pollutants in excess of standards, caused “large-scale pollution accidents or incidents,” or refused to carry out administrative penalty decisions (Art. 11). In contrast with the broadly worded OGI Regulations, which declare that governmental units at the county level and above “emphasize” disclosure of certain categories of information, the OEI Measures state that EPDs “shall” disclose the listed items.

A distinctive feature of the OEI Measures is that besides requiring release of records by EPDs, the OEI Measures “encourage” —and in some cases require— companies to release their own “records” related to environmental conduct and impacts (Art. 19). For instance, Article 19 provides that enterprises may voluntarily release records on “annual consumption of

natural resources,” “investment in environmental protection and technology,” and “the type, amount, toxicity, and destination of the enterprise’s discharged pollutants.” In addition, the OEI Measures *require* “bad actor” companies to disclose their names and legal representatives; the amount, toxicity, and method of discharge of major pollutants; and emergency response plans (Art. 21). In most cases, EPDs, either proactively or in response to requests, are required to disclose information within 15 to 30 days from the time the information is generated or modified, or a request is received (Arts. 14 & 18).

Disclosure of the above is subject to important exceptions. For example, Article 12 prohibits disclosure of government environmental information involving “state secrets, commercial secrets, or individual privacy.” The law imposes a total bar on the release of such information in accordance with “China’s Law of the PRC on Guarding State Secrets.” Strictures on releasing commercial secrets or personal privacy information are more qualified. The bar may be waived if a company or person consents to release or if the “environmental department believes that not disclosing such information could significantly impact the interests of the public” (Art. 12). Another provision prohibits using disclosed information to “harm national interests, public interest, or the lawful rights and interests of other persons when using disclosed environmental information” (Art. 7).

The OEI Measures constitute one component of a broader framework of laws that have mandated openness in government affairs. In 2002, for example, the Standing Committee of the National People’s Congress (NPC) (China’s legislature) enacted a “Law on Evaluation of Environmental Effects” (EIA Law), which for the first time incorporates provisions for public participation in China’s environmental impact assessment (EIA) system. Articles 11 and 21 of the EIA Law require the sponsors of government development plans and construction projects with potentially “adverse” or “considerable” effects on the environment to provide the public with opportunities to comment on draft “Environmental Impact Reports” (EIRs) prepared for such proposals. These provisions require sponsors to solicit comments on draft EIRs

through hearings, demonstration meetings, and “other methods” before submitting the EIRs for examination and approval by MEP or lower level Environmental Protection Bureaus (EPBs). To implement the EIA Law’s requirement, SEPA (MEP’s predecessor) adopted Provisional Measures on Public Participation in Environmental Impact Assessment (“EIA”) that took effect in March 2006. Moreover, in 2003, the Standing Committee of the NPC adopted the Administrative Permission Law (APL), which standardizes the procedures and principles by which administrative departments grant approval to “citizens, legal persons, and other organizations” who apply to engage in activities that relate to a broad range of identified matters, among them “protection of the ecological environment” (Art. 11). In somewhat tentative wording, the APL states that “administrative departments shall make known to the general public and hold hearings” when required by law or “on other matters of vital importance involving public interests for the granting of administrative permission which the administrative department believes need hearing” (Art. 46). However, the APL clearly provides a right to a hearing where the administrative permission involves “the vital interests between an applicant and another person” (Art. 47). In such cases, the applicant and other interested persons have the right to request a hearing.

The foregoing laws and regulations resonate with the Chinese government and Communist party’s official promotion of “openness” and “transparency” as tools to bolster administrative efficiency and accountability, check corruption, and institute a “service-oriented” government. For example, President Hu Jintao and Premier Wen Jiabao, in major reports before last year’s 17th Chinese Communist Party Congress and the first plenary session of this year’s NPC, extolled the benefits of openness and proclaimed the “four big democratic rights”: “right to be informed,” “the right to participate,” “the right of expression,” and the “right to supervise.” The official press also frequently trumpet these themes; for example, Xinhua, the Chinese government’s official news agency, touted this year’s plenary session of the NPC as the most open in China’s history, highlighting the access to international media and the publication of name lists of NPC delegates.

## **Reflections on Secrecy in China in Light of Author’s Experience Conducting a Law Clinic at Sun Yat-Sen University in China**

During 2004-05, the article author served as a Yale-China Association legal fellow at Guangzhou’s SYULS, where he assisted the school in developing an upstart environmental law clinic. SYULS is among a growing number of Chinese law schools that have developed clinical law programs with key U.S. foundation support. Clinical legal education, which originated in the United States, is a law teaching methodology that emphasizes experiential learning. In China, as in the United States, law clinic students, under the supervision of trained attorneys, have the opportunity to represent clients in court, provide legal education to their communities, draft legislation, and conduct legal investigations. Consistent with the public service orientation of clinical education, most clinics provide pro-bono or low cost legal assistance to poor, handicapped, and other interests that have traditionally had limited access to legal services.

During the fall and winter of 2004-2005, the author developed and conducted four law clinic projects, primarily in the Guangzhou metropolitan area, in which student teams conducted field research examining such issues as transparency, civil society development, public participation, and environmental assessment. Using material obtained through interviews and onsite visits, the students composed case studies, reporting on their research. Notably, the students began their research shortly after passage of the EIA Law and APL but before enactment of the OEI Measures, discussed above. Guangzhou as a locus of the student projects is also noteworthy because the city earned a reputation for openness as the first jurisdiction in China to adopt an open information law, the “Guangzhou Municipal Provisions on Open Government Information,” which took effect in January 2003.

The following section highlights one of the law clinic research projects: a proposal to locate a communicable disease laboratory in a residential area. While investigating implementation of China’s EIA Law was the immediate impetus for the project, this case study provides a window into issues of openness, transparency, and public notice, generally, and serves

as a platform for discussing the significance of the recent OEI Measures.

## **Guangdong Disease Control Center**

In 2003, the Guangdong Province Disease Control Center (DCC) initiated plans to relocate its outdated facility from cramped quarters in Guangzhou City. The SARS epidemic, which struck China in 2002-2003, became a spur for the relocation project, impressing on provincial officials the need for a larger, “first-class” facility with modern equipment. In early 2003, with the provincial governor’s endorsement, the modernization project appeared headed toward swift approval and construction.

Through interviews of government officials, journalists, and homeowners, the students chronicled the chain of approvals the DCC proposal received from various Guangdong Province and Guangzhou City environmental agencies. These included the Guangdong Province Development and Planning Commission in fall 2003, followed in turn by the Guangzhou Planning Commission, and Guangzhou State Land Office in early 2004. The proposed site for the relocated DCC was Panyu, a booming southern suburb of Guangzhou with numerous tracts of new middle-class, residential high-rises. The surrounding population numbered approximately 100,000 persons.

The general public learned about the proposed DCC not through public disclosure by any of the governmental departments involved in the approval process, but rather in a small article that appeared in a Guangzhou newspaper. The report was published at an advanced stage of the approval process when the Guangzhou Planning Commission had already approved a plan to relocate the DCC in Panyu. Interviewed at their apartment complex near the proposed DCC site, the professional, upper-middle class residents expressed alarm about being infected by a pathogen in case of a facility accident, as well as the possibility that a nearby communicable disease laboratory would lower the value of their homes. The residents, who had not organized into a homeowners’ association, made some ineffectual attempts at collective action to express their concerns. For

example, a few set up a Web site on which to exchange their views, while others circulated a petition letter within the apartment complex. However, these efforts generated little response.

Suddenly, in a curious development, the DCC project, which seemed on the verge of approval, came to halt. By a curious happenstance, one of the residents in the area of the project was a member of the Chinese People’s Political Consultative Conference (CPPCC), an important advisory body in China’s government structure. The member, with the support of Guangdong Province colleagues, circulated a motion before the CPPCC calling for a suspension of the DCC pending further study. The petition highlighted the dangers and complications of locating a sensitive facility in a densely populated residential area and called for convening a hearing or experts meeting. Passage of the motion induced the Guangdong Public Health Department, which has jurisdiction over the DCC, to announce in September 2004 that the project would be suspended pending further study. In the students’ opinion, the fact that an influential person rather than institutionalized channels of public feedback was an essential factor in cancelling the project proposal revealed the importance of “guanxi” or relations in Chinese public life.

In their legal analysis of the case, the students expressed the opinion that the DCC proposal qualified as either a “special plan” or a “construction project” under the EIA Law, and that because the relocated DCC had the potential to “cause adverse effects on the environment,” the DCC administration (or its parent, the Guangdong Public Health Department) should have prepared a draft EIA and provided for public comment on it prior to submitting the proposal for approval. The students reported that, based on their research, neither the DCC nor any of the relevant approving departments conducted public participation activities (such as hearings or demonstration meetings) as provided by the EIA Law. Based on their communications with agency officials (some did not respond to inquiries), the students surmised that the requirement to prepare an EIA never “entered the mind” of the agencies in the approval pipeline. Moreover, in the opinion of the students, citing the

APL, the Panyu residents were persons whose “vital interests” were affected by approval of the DCC, and as such were entitled to a hearing to air their concerns. The students also questioned Guangdong Province Environmental Protection Bureau (EPB) officials on the issue of whether an EIA should have been prepared for the project given that the EIA Law assigns to EPBs the role of examining and approving EIRs prepared by planning and construction units (Art. 13). The EPB officials responded that the DCC should have prepared an EIR for the project, and that EPB officials were still “waiting for the EIR to arrive.” In sum, the student found the posture of the EPB “passive” and “disconnected.”

The students’ discovery that the public never received governmental notice of the DCC project prompted them to review the public Web sites of the provincial and Guangzhou agencies involved in the DCC’s approval in order to evaluate the sites for their degree of “openness.” Noting that such Web sites were created under such slogans as “open window to government” and “government under sunshine” during Guangdong Province’s relatively long history of promoting open government, the students observed that the content did not often match the rhetoric. For example, the bulk of the information was general in nature, such as posting of laws, regulations, and policies, but offered little concrete and timely information on government actions or developments that might elicit public feedback or interest. The students were particularly struck by the fact that the DCC’s Web site contained almost no information about the relocation proposal the agency had directly sponsored.

The author’s review of the Web sites three years later reveals their content is still largely tilted towards more general information such as laws, regulations, circulars, policies, and staff rosters. Some of these sites do identify development plans, but the author was unable to find any news regarding hearings or other forms of soliciting public opinion related to the EIA Law. The Guangdong EPB Web site, where one would expect to find information regarding matters involving projects with environmental impacts, also fits this general pattern. Although the Guangdong EPB site does disclose long lists of projects for which EIRs have been

conducted, and in one case provides a synopsis of the EPB’s approval of an already completed construction project EIR, the site does not provide specific information about opportunities to request hearings or other methods of expressing opinions on pending projects. (A law professor acquaintance from Guangzhou confirmed the lack of such information on Web sites, but also noted that EIA hearings of any type are a “rarity” in Guangzhou). While the information these Web sites do provide is significant, this recent Web site revisit appears to confirm the clinic students’ impression that the sites lack timely and specific information that could foster public participation and better inform the decisionmaking process.

## Conclusion

By adopting the OEI Measures, MEP distinguished itself among Chinese administrative agencies in implementing the information disclosure regime broadly mandated by the State Council’s landmark OGI Regulations. By specifying types of information that EPDs must release proactively, the OEI Measures enable Chinese to know more about how their traditionally opaque government functions. Furthermore, by giving citizens a right to request record information from their government, the OEI Measures enable the Chinese to more effectively probe the basis of governmental decisionmaking and hold officials accountable in their actions and public statements. The requirements for enterprises in certain situations to disclose information about the amount and toxicity of their releases—though not approaching a U.S. style Toxics Release Inventory—are also significant.

At first blush, passage of the OEI Measures tempts one to imagine how the Panyu clinic case study would have unfolded differently if the OEI Measures had been in place at the time. One optimistic scenario is that better informed Panyu residents would have learned about the DCC project sooner and pressured authorities to require some form of environmental review under the EIA Law. Perhaps the residents could have been more effective and self-reliant in their advocacy and less dependent on the fortuity of having a well-connected fellow neighbor.

Without discounting the significance of the OEI Measures, below are some reflections on the limitations of the OEI Measures and other related open government law based upon the Panyu case study and more general observations.

The Panyu case study foreshadows some of the risks of a piecemeal approach to information disclosure. So far, MEP is the only administrative agency to have enacted implementing measures to carry out the OGI Regulations, and the OEI Measures are limited to MEP and its subordinate agencies. However, as the Panyu case study illustrates, the approval pipeline for the DCC and other projects with environmental consequences may include multiple agencies, such as planning and land use agencies that are not subordinate to EPDs. If one or more agencies in the approval pipeline do not disclose information about administrative approvals, this may allow projects to escape public notice and prevent other agencies from exercising their proper function. This seems to be what happened in the Panyu case because the Guangdong EPB was apparently caught off guard by the already advanced (but undisclosed) stage of DCC project approval. The result was that the EPB was unable to fulfill its role of overseeing the EIA process. Thus, inconsistent standards and uneven commitments to information disclosure among different bureaucracies may result in little on-the-ground improvements in disclosure.

Another limitation of the OEI Measures is uncertainty about the breadth of record disclosure when the OEI Measures are viewed in conjunction with other laws that define a certain scope of information release. For example, the Provisional Measures on Public Participation in EIA (Provisional Measures) (see above) have received criticism for requiring public release of abridged or summary versions of EIRs rather than complete EIRs (Arts 11). It is not completely clear whether one could nevertheless overcome this limitation by using the record request provision of OEI Measures to obtain a full copy of the EIR. Also, the scope of disclosure under the OEI Measures is determined to some degree by the recordkeeping mandates of other laws. By this criterion, the Provisional Measures and the APL offer

some encouragement because the Provisional Measures and APL require keeping a record of EIA hearings (Art. 31) and administrative permit hearings (Art. 48), respectively. Thus, these laws create a record “paper trail” that presumably would be within the reach of the OEI Measures’ disclosure function.

Perhaps the most serious damper on OIE Measures’ effectiveness is the possibility that the “state secrets” exception will significantly curb disclosure of information, and thus undercut their beneficial impact on government accountability. As noted above, the OEI Measures prohibit disclosure of state secrets in accordance with the “Law on Guarding State Secrets.” This law broadly defines state secrets as “matters that affect the security and interests of the state” (Art. 2) and invests agencies with great discretion in defining the scope of secrecy. There are similar restrictions on the release of state secrets in the APL and EIA Law. The freewheeling manner in which authorities have traditionally wielded “state secrets” to bar access to information justifies skepticism about how much disclosure the OEI Measures will achieve. With regard to the EIA Law, invocation of the state secrets exception has already been a recurrent theme in limiting release of EIRs for several proposed construction projects in recent years. For example, in widely reported recent controversies over plans to build a chemical factory in the city of Xiamen and a waste-to-energy incinerator in Beijing, the governments withheld certain EIR sections on the grounds that they contained state and commercial secrets, thereby aggravating the ire of concerned middle-class residents. (Eventually, protests by residents led to the relocation of the chemical plant and suspension of the incinerator plan pending further study). Jamie Horsley, of the Yale University Yale-China Law Center, who frequently comments on open government developments in China, has observed that the OGI Regulations, in view of the broad state secrets exception and other limiting language, do not establish a clear presumption of disclosure with narrowly drawn exceptions to disclosure. In this regard, the OGI Regulations—and the OEI Measures that implement them—differ greatly from the Freedom of Information Act, which establishes a presumption of disclosure (5 U.S.C. section 552(d)) and enumerates the specific matters

that are not subject to disclosure (5 U.S.C. section 552(b)(1)-(7)).

The adoption of the OEI Measure represents an important passage in building a system of open government information in China and thus strengthening the country's rule of law. As noted above, however, the particular language of the OEI Measures raises uncertainty about how much environmental information will actually be disclosed. Furthermore, the OEI Measures' provision allowing persons to challenge denial of an information request in court may offer less protection than at first appears, since administrative litigation is extremely difficult in China, a topic beyond the scope of this article. Most important, it bears mention that open government is at an incipient stage in China. As the Panyu case study illustrates, even in relatively progressive jurisdictions such as Guangzhou and Guangdong Province, non-disclosure and lack of transparency in government operations remain endemic. In this regard, the difficult track record experienced under other earlier open government laws discussed above casts doubt on the possibility that the OEI Measures might usher in change overnight. For example, on a recent posting on a Chinese environmental chat room, a writer complained about being ousted from an EIA hearing on a proposed "waste to energy project" to be located near the large city of Nanjing. The writer claimed that the hearing organizers' actions in preventing the writer and fellow elderly residents from attending the hearing, as well as surrounding the hearing venue with police, contravened the guarantee of an "open hearing" pursuant to Article 28 of the EIA Provisional Measures. The writer also mocked the event as a "sham" hearing that was contrived to "sing the praises" of the proposed project. While the foregoing account is not meant to diminish the import of the new OEI Measures, the building of an open information regime will likely have to contend with traditions of secrecy in Chinese government for some time to come.

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**AMERICAN BAR ASSOCIATION  
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Sept. 17-20, 2008  
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## AMENDMENT TO THE U.S. LACEY ACT: IMPLICATIONS FOR CHINESE FOREST PRODUCTS EXPORTERS

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### Introduction

The recently-passed 2008 U.S. Farm Bill extends a century-old law, the Lacey Act, to give the U.S. government the power to fine, and even jail, individuals and companies who traffic in illegally-harvested wood and other plant products. This new law, and the import declaration it requires, will affect a broad range of manufacturers and importers of a variety of products made from wood, including paper, furniture, lumber, flooring, plywood, or even picture frames.

The impact of this new law is more clearly understood when considered in the context of U.S. imports of forest products from China. The United States is one of the top consumers of forest products globally, and China is one of the largest producers and suppliers of forest products for the U.S. market. In 2007, U.S. imports of Chinese forest products were 22 percent of China's total forest product exports, totaling 15.7 million cubic meters in volume (measured in round wood equivalent, or RWE), and \$8.5 billion in value.

China's imports of logs and timber for its wood processing industry have been steadily increasing. The demand for these inputs results from both rapidly expanding exports of forest products to the United States and other countries (see Figure 1) and fast-growing demand for downstream forest products such as paper, lumber, and furniture within China, a country with relatively low per capita forest resources.

Today, China is a major net importer of forest products, including logs, timber, and pulp from supply countries such as Russia, Malaysia, Indonesia, the Solomon Islands, and Papua New Guinea. Problems relating to illegal harvesting in many of these supply countries mean that many downstream forest products exported to the U.S. market may originate from illegal sources. Thus, manufacturers, exporters, and retailers

of goods made in China with suspect timber could face forfeiture, penalties, and even imprisonment under the newly-amended U.S. law.

### Current Context

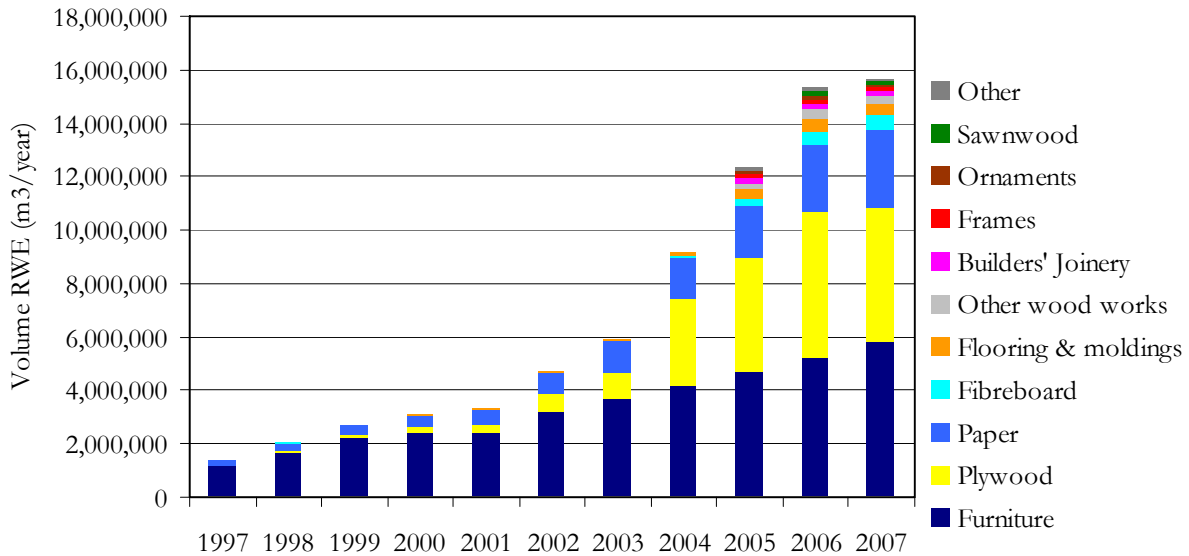
The 2008 U.S. Farm Bill extends the Lacey Act to reach products made from timber and plants taken or transported in violation of U.S. laws or—more importantly for Asian exports—in violation of the laws of the country in which the timber was harvested. The Lacey Act will now apply to a broad range of imported wood products and species, far beyond those few species listed as endangered under the Convention on International Trade in Endangered Species (CITES). The U.S. Department of Justice already has indicated that it intends to use the act to combat the trade in illegal timber, and will actively enforce new declaration and paperwork requirements. Penalties under the act include civil administrative penalties, forfeiture of the trafficked goods, criminal fines, or imprisonment. A Lacey Act violation may also trigger charges of smuggling or money laundering.

A recent indictment illustrates the potential for other enforcement action against imports of furniture made with illegally logged timber. On April 16, 2008, a federal grand jury in Newark, New Jersey, indicted a Chinese furniture maker under the Endangered Species Act and the anti-smuggling statute for importing a container of baby cribs made with ramin, an endangered tree species listed under CITES. The goods have already been forfeited, and the indicted person and company face potential imprisonment and hundreds of thousands of dollars in fines.

In order to avoid problems with the new provisions of the Lacey Act, there are several common sense measures that exporters and importers of wood-containing products can take.

- Pay attention to your customers—Customers will be asking increasingly detailed questions about wood sourcing. Manufacturers and exporters/importers may be able to attract new customers—or lose them—depending upon what assurances they can provide about the legality of their wood inputs.

**Figure 1: U.S. Imports of China's Forest Products, 1997-2007**



Source: China Custom's data, compiled by Forest Trends.

- Understand your sourcing—Manufacturers and exporters/importers should put a management process in place designed to investigate the product supply chain and provide documented assurance that potentially illegal wood products are not being received and used. Companies and company officials who simply ignore potential sourcing problems can still be found liable for violations of the Lacey Act.
- Do not rely on “paper” assurances—Some of the provisions of the Lacey Act apply regardless of whether a firm has actual knowledge of illegalities in the sourcing of a product’s raw materials. It is not enough to simply get a letter or contract from your supplier stating that the wood products were legally obtained. Although helpful, such a document may not prevent the forfeiture of product if the government has reason to believe the wood was illegally obtained.
- Structure contracts to protect your financial interests—Wood or paper product importers can structure contracts so that they pay for, and take possession of, the product only after

it has been cleared through Customs. Similarly, firms manufacturing paper or wooden products can contractually require indemnification from wood suppliers for any financial harm resulting from U.S. government actions taken against products.

- Pay attention to the regulations—The U.S. government will be issuing regulations, likely by late 2008, that will provide guidance regarding the import declaration requirements. Firms need to be aware of what those regulations may entail and how they may affect business.

### Foreign Timber Laws Enforceable in U.S. Courts

The Lacey Act extends the reach of foreign laws and regulations by making it a violation of United States law to traffic in products made from wood that was harvested, transported, or sold in violation of foreign laws—such as forest management laws and regulations in producer countries such as Russia, Indonesia, Gabon, or Peru. The penalties depend on the extent to which a person handling goods actually knows, or should have known in the exercise of due care, that the

goods are, or are made with, illegally taken trees and plants. The key to avoiding or minimizing penalties is exercising due diligence in the sourcing of wood inputs.

## **New Import Declaration Requirements for Wood Products**

Congress also added new import declaration requirements that reinforce the need to know precise sourcing information. Beginning in late 2008, importers will be required to declare the scientific name(s) of any timber contained in the goods, the value of the importation and the quantity of the wood product, and the name of the country, or countries, from which the timber was taken. Importers will need to obtain this information from their suppliers, and the suppliers will need to keep track of this information on a regular basis. The law does allow, at least initially, for exporters to list multiple likely countries of origin and/or possible species of the wood, if that information is unknown.

## **Next Steps for the U.S. Government**

The Lacey Act ban on imports of illegally harvested wood products is already in effect, but the U.S. government will need to issue regulations to implement the new legislation. These new regulations will clarify the import declaration requirements, which will go into effect in late 2008.

The U.S. government may use the new Lacey Act tools to take high-profile enforcement efforts in the near future and send a message to foreign exporters. The Department of Justice can already bring prosecutions under the expanded Lacey Act, even if the import declaration requirements are not yet in effect.

## **Violations of the Lacey Act**

Prosecution under the Lacey Act requires proof of two violations, an “underlying” violation and an “overlying” violation. The “underlying” violation would be a breach of a foreign or U.S. state law that regulates the taking, possession, importation, exportation, transportation, or sale of fish or wildlife or plants. The “overlying”

violation would be the breach of the Lacey Act ban on importing, exporting, transportation, sale, acquisition, or purchase of the tainted goods. The prosecution must take place within 5 years after the Lacey Act violation.

The Lacey Act amendments laid out a broad list of potentially illegal activities covered by the act as “underlying” violations. The list covers readily understandable violations of law, such as the illegal harvesting of timber in national parks. However, the Lacey Act may also extend to less obvious activities, such as the transporting of timber at night in violation of a curfew designed to combat illegal timber trafficking. Under the Lacey Act amendments, “underlying” violations include violations of laws that generally “protect plants,” or of laws that regulate:

1. the theft of plants;
2. the taking of plants from a park, forest reserve, or other officially protected area;
3. the taking of plants from an officially designated area; or
4. the taking of plants without, or contrary to, required authorization.

In addition, “underlying” violations also include the failure to pay appropriate royalties, taxes, or stumpage fees and violations of laws governing the export or transshipment of plants.

## **Penalties under the Lacey Act**

The penalties for a Lacey Act trafficking violation depend on the defendant’s knowledge (*mens rea*) regarding the underlying violation of foreign law.

Civil administrative penalties: The government may impose significant civil penalties on any person committing a violation of the Lacey Act. If the defendant actually knew, or in the exercise of due care should have known, that the fish, wildlife, or plants were taken, possessed, transported, or sold in violation of an underlying law, the government can assess a civil penalty up to \$10,000. For example, the National Oceanic and Atmospheric Administration (NOAA) regularly proves lack of “due care” by fish importers by showing that the respondent is in the commercial fishing business.

The agency with jurisdiction over the offense may issue a notice of violation and assess a civil administrative penalty. If the defendant contests the penalty, the agency must prove its case to an administrative law judge by a preponderance of the evidence.

**Forfeiture:** Fish, wildlife, or plants imported in violation of the Lacey Act are subject to forfeiture even if the defendant did not know of the underlying violation (e.g., that the timber was harvested illegally). Although U.S. criminal laws generally provide for an “innocent owner defense” for forfeitures, this defense does not apply where the property to be forfeited is “contraband or other property that it is illegal to possess,” likely including goods whose possession is illegal under the Lacey Act. *United States v. 144,774 Pounds of Blue King Crab*, 410 F.3d 1131 (9th Cir. 2005). Vessels, vehicles, aircraft, or other equipment used in the commission of a Lacey Act felony (see below) are also subject to forfeiture after a felony conviction if the owner knew, or in the exercise of due care should have known, they would be so used. The Customs rules on forfeitures apply to all forfeiture proceedings.

**Fines and imprisonment:** If a party knowingly engages in illegal trafficking, while knowing that the fish or wildlife or plants were taken, possessed, transported, or sold in violation of an underlying law, it is subject to felony prosecution, and penalties of up to a \$250,000 fine (\$500,000 for organizations) and/or up to 5 years imprisonment. *United States v. Eisenberg*, 496 F. Supp. 2d 578, 582 (E.D. Pa. 2007) (holding that when Congress enacted 18 U.S.C. § 3571 in 1984 (and added 18 U.S.C. § 3571(e) in 1987), it repealed the lower fines contained in the Lacey Act). If the party in the exercise of due care should have known of the underlying violation, the offense is a misdemeanor subject to penalties of up to a \$100,000 fine (\$200,000 for organizations) and/or up to one year imprisonment. Each violation is a separate offense.

**Smuggling and money laundering:** Importers who bring in goods in violation of the Lacey Act can also be prosecuted for violations of the smuggling statute, 18 U.S.C. § 545, a Class D felony. A smuggling charge can also support a felony money laundering

charge for transferring money from the United States to the foreign seller “with the intent to promote the carrying on of a specified unlawful activity,” because smuggling is an unlawful activity. *United States v. Lee*, 937 F.2d 1388 (9th Cir. 1991). Finally, the declaration requirements in the new law may trigger the felony false statement statute, 18 U.S.C. § 1001, which provides that a person who knowingly and willfully makes materially false statements, makes or uses false documents, or conceals material facts, is subject to a fine and/or imprisonment for a period of up to 5 years.

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