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Kirkland Alert

## China's New Soil Pollution Prevention Law Creates Obligations and Liabilities for Companies with Industrial Sites in China

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On January 1, 2019, China's new Soil Pollution Prevention and Control Law (the "Law") came into effect, having significant implications for certain industrial sites in China. Prior to a property transfer, the Law requires land use rights holders<sup>1</sup> of certain industrial facilities on "Supervision Lists" (as defined below, many of which have yet to be published) to undertake soil and groundwater investigations and/or conduct remediation.

Investors and businesses operating industrial facilities in China should prepare for such issues to arise in corporate mergers and acquisitions by carefully reviewing the Law to understand its applicability and continuing to monitor administrative regulations implementing the Law. Investors conducting due diligence on industrial facilities in China should consider the potential for such liabilities to arise upon their exit and seek to ensure that sellers are complying with obligations triggered by the proposed transaction. Penalties for noncompliance have increased significantly to up to ¥2 million and executives responsible for severe violations may face administrative detention.

### Overview of the Soil Pollution Prevention Law

Passed by the National People's Congress on August 31, 2018, the Soil Pollution Prevention Law is the first comprehensive framework law in China addressing soil pollution, creating new obligations and potential liabilities for land use rights holders in China.

The Soil Pollution Prevention Law generally requires the Responsible Person (i.e., the person who caused the contamination<sup>2</sup> and any successors) to implement risk control and remediation measures and to pay for all costs associated with investigating, remediating and managing soil contamination. Where it is not possible to identify the Responsible Person, the land use rights holder must implement risk control and remediation measures pursuant to the Law.

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For construction-use land (e.g., industrial sites), the Law sets forth the following process for identifying and remediating soil contamination:

- Land use rights holders must investigate soil conditions upon the government's identification of soil pollution risk.
- If the investigation reveals pollution in excess of relevant standards, the Responsible Person and the land use rights holder must complete and file a soil pollution risk assessment report.
- Based on its review of the risk assessment report, the government may include the property in a list of construction land subject to soil pollution risk management, control and remediation, in which case the Responsible Person must take measures to monitor, manage and control soil and groundwater pollution risks.
- If remediation is required, the Responsible Person must prepare a remediation plan, which covers prevention and cleaning up of polluted groundwater.
- Once completed, the Responsible Person must (i) engage an independent entity to evaluate the results of its risk management, control and remediation measures; and (ii) file the evaluation report with the government.

Under the Law, penalties for noncompliance have been increased significantly to up to ¥2 million and administrative detention may be imposed on executives responsible for severe violations.

# Types of Industrial Sites Most Likely to be Affected by the Law

While the Soil Pollution Prevention Law broadly addresses construction-use land, its focus is centered on certain types of industrial sites, including: (i) facilities on Supervision Lists for soil pollution; and (ii) facilities that are being returned to the government or rezoned. Each of these types of facilities is potentially subject to obligations to undertake intrusive soil and groundwater investigations and is subject to more regulatory scrutiny.

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**While the Soil Pollution Prevention Law broadly addresses construction-use land, it focuses on such facilities listed on Supervision Lists or which are being returned to the government or rezoned. Transactions involving the transfer of such facilities may trigger certain obligations under the Law.**

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## Facilities on “Supervision Lists” for Soil Pollution

Government authorities have been tasked with creating “Supervision Lists” of industrial facilities in each city across China that will be subject to increased government inspections. While the Supervision Lists have yet to be published in many jurisdictions, industrial facilities in a number of specified “high polluting industries” (i.e., those engaging in nonferrous metal smelting, petroleum processing, chemical processing, coking, electroplating and tanning; those generating more than 100 tons of hazardous waste annually; those storing hazardous waste; waste disposal facilities; or sites with a history of soil or groundwater contamination within the past three years) are expected to be included on such lists. Some jurisdictions, such as Suzhou and Shanghai, have published their Supervision Lists; companies should routinely check their jurisdictions' governmental websites for updates.

Where contamination is found to have the potential to cause adverse human health effects beyond the boundary of the site, the land use rights holders must control the contamination onsite and/or remediate the contaminated site. Industrial facilities on

Supervision Lists will also be required to conduct soil and groundwater investigations during site expansion or modification.

### Facilities that are Rezoned

Intrusive soil and groundwater investigations must be undertaken and an investigation report must be filed with government authorities if: (i) an industrial facility is on a Supervision List; and/or (ii) the land underlying such facility is being returned to the government or being rezoned (likely from industrial to residential or public service). Where contamination is identified, the Responsible Person or the land use rights holder is responsible for remediation of the contamination and associated costs.

While industrial facilities that are not named on a Supervision List are not obligated to undertake soil and groundwater assessments where land is handed back to the government and the land is not rezoned, owners of facilities that are found to cause soil or groundwater contamination or their successors would still be liable for remediation costs as Responsible Persons.

## Implications for Investors and Owners/Operators in China

### Proactive Measures for Owners of Facilities Suspected to Have Contamination

Owners and operators of industrial facilities that are known or suspected to have soil or groundwater contamination may want to be proactive and take steps to limit exposure. Depending on the circumstances, such steps could include:

- Establishing liability for soil and groundwater contamination in lease or land use agreements;
- Identifying and removing known sources of contamination before government intervention and before exiting a site; and
- Controlling contamination to within the site boundary and testing boundary soil and groundwater quality to monitor the potential for contamination of adjacent properties.

### Increased Need to Assess Contamination Risk in Due Diligence

Due to the obligations of land use rights holders in the Soil Pollution Prevention Law, investors and companies face an increased need to assess contamination risk as part

of doing deals in China. There had previously been little incentive or regulatory trigger to assess soil contamination risk at facilities in China; there had only been a handful of provisions pertaining to soil pollution across a number of laws that did not impose clear obligations or clear penalties for noncompliance. In light of the obligations and potential liabilities under the Law, a more thorough analysis of soil contamination risk at facilities in China may be warranted in due diligence.

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### Investors and Owners/Operators in China Should Continue Monitoring Additional Regulations

The Soil Pollution Prevention Law sets forth a framework for establishing national standards for soil pollution risk control that will be further fleshed out in implementing administrative regulations. In the coming years, administrative regulations are likely to be issued with respect to:

- What qualifies as a transfer of a property – the current regulations do not appear to address whether a direct or indirect stock transfer or a restructuring of a business operating at a subject property would qualify as a transfer (or rather, more narrowly, if only a direct transfer of land use rights and associated business assets would qualify);
- Timing for meeting the various transaction-triggered obligations;
- Directory of entities subject to key supervision for soil contamination;
- Risk-control standard for soil contamination (both national standard and local standard);
- Rules on determining the Responsible Persons for soil contamination; and
- Inventory of construction land subject to soil contamination risk control and remediation.

Investors and owners/operators of industrial sites in China should continue monitoring these administrative regulations to assess the effect of these administrative regulations on their businesses and potentially provide comments during rulemaking processes.

# Next Steps

Investors and companies operating industrial facilities in China should carefully review the Soil Pollution Prevention Law to understand their obligations. The Law marks a significant departure from prior regulatory requirements in China and imposes civil, administrative and even potential criminal liabilities for different violations. To comply, companies with operations in China may need to initiate soil investigations or take immediate risk control and remediation measures if soil contamination has been identified. Further, investors and operators should monitor accompanying regulations to best position their businesses.

Next steps to consider include:

- With respect to existing operations and businesses, engaging legal counsel and technical environmental consultants to consider the potential implications of the Law;
- With respect to potential transactions involving industrial operations in China, engaging legal counsel and technical environmental consultants to assess the risk of soil contamination and advise on obligations potentially triggered by the Law in the event of a transfer of the property; and
- Tracking and, to the extent possible, commenting on the administrative regulations that implement the Law.

If you have any questions about the matters addressed in this *Alert*, please contact the following Kirkland authors or your regular Kirkland contact.

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1. Under PRC law, a land use right is a property right enjoyed by private parties and protected by law similar to a long-term leasehold. See further discussion: <https://www.pinsentmasons.com/mediafiles/1905363983.htm>.↵

2. Note that the Soil Pollution Prevention Law does not explicitly define “Responsible Person.” However, based on China’s 2016 Soil Action Plan, the Responsible Person appears to be the person who causes the soil contamination and any successors.↵

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