



JONES DAY  
**COMMENTARY**

## CHINA'S CONSTRUCTION INDUSTRY COMES UNDER THE MICROSCOPE

The construction industry in China has grown side by side with the Chinese economy, and the recent RMB 4 trillion (US\$593 billion) government stimulus package has helped to fuel this growth in construction and infrastructure development. However, problems in land acquisition, construction quality, and corruption have hampered China's construction industry and continue to derail the government's efforts to improve and upgrade the industry to meet international standards. In fact, during the last three months, there have been high-profile residential building collapses in Shanghai, Chengdu, Zhejiang, Jiangsu, and Shijiazhuang, in some cases resulting in loss of life.

Consequently, in August 2009, the Chinese government publicly announced that it would launch a two-year project to address these problems, which the government acknowledged had "harmed the public's basic interest, broken market rules and gone against the goal of building a harmonious society."

### THE PROBLEMS

On July 9, 2009, the general office of the Central Committee of the Communist Party of China and the State Council jointly issued "Zhong Banfa" Document No. 27, which states that many problems have been found within the construction industry in China that have harmed the development of the industry as well as the public interest.

Document No. 27 identifies the main problems as:

- Money-for-power deals and commercial bribery, whereby some officials abuse their power to acquire personal gain.
- Some local governments operate approval and lease procedures illegally, and change the use categorization of land and increase the utilization rate of construction without approval.

- Some contractors illegally subcontract construction work.
- Some tendering agencies operate illegally.
- Some local governments waste taxpayers' money by constructing lavish buildings.
- Some contractors violate safety and quality regulations.
- Some local governments requisition land illegally during the construction process.
- There should be enhanced supervision over key aspects of government construction projects.
- A more transparent construction project information system should be established to prevent officials from abusing their powers to earn personal profits.
- More advice should be sought from experts as well as the public.

## THE INVESTIGATION

Document No. 27 states that over the next two years, officials at all levels of government will be ordered to start inspecting all construction projects for which they are responsible, to ensure that these problems are not repeated.

An inspection team made up of officials from 19 government departments, led by the disciplinary watchdog under the Central Committee, has been established to supervise the implementation of Document No. 27 by local governments, and this inspection team will also tour the country to check and verify the results of the inspection campaign.

The specific measures mandated by Document No. 27 include:

- Local governments should further regulate the working procedure of land management and make more efforts in supervising the sale and purchase of land use rights.
- Local governments should practice self-examination to determine the main problems from every key point, such as approval, land sales, and tendering procedures. Those who refuse to perform this self-examination or try to cover up problems will be punished.

- Implementation regulations for the Law of the People's Republic of China on Tenders and Bids should be issued.
- Articles on government investment and articles on construction market management should be drafted.
- Industry standard documents for tendering should be prepared.

Several local governments, such as Guangdong and Anhui, have already begun to implement Document No. 27 by issuing their own plans on August 18, 2009.

## IMPACT ON FOREIGN CONSTRUCTION COMPANIES

While it is clear that Document No. 27 is aimed primarily at government-invested construction projects, that does not mean that foreign-invested projects or companies will be immune from the investigation. In fact, now is the time when foreign-invested projects need to be "cleaner than clean" as the spotlight is turning on the industry as a whole.

For example, foreign-invested design and construction companies need to ensure that their qualifications and licenses are up-to-date and in line with the business scope they wish to undertake in China. Similarly, companies attempting to operate "under the radar" and without appropriate

qualifications in China appear to be increasingly at risk. In all cases, corporate governance and other internal policies, especially those relating to anticorruption, should be reviewed and updated, if necessary. Practices such as splitting projects or splitting contracts should also be reviewed to ensure compliance with the various construction regulations. Further, it seems that subcontracting will be a particular area of focus, and therefore foreign-invested construction companies need to think carefully about how they will plan and resource their projects in China.

All is not doom and gloom, however, as the investigation could also prove to be an opportunity for foreign-invested design and construction companies in China. Their emphasis on high quality and their refusal to sacrifice safety should be compelling competitive advantages in this market. Project management and construction/design integration services should also receive a boost if they can demonstrate tangible quality and safety improvements at reasonable cost.

Having said all this, the recent high-profile foreign corruption revelations, together with this current investigation, suggest that the construction industry in China will increasingly come under the microscope on the compliance front. This means it is important that foreign-invested design and construction companies in China put their houses in order and continue to adopt and maintain the highest international standards for their projects and operations in China.

## LAWYER CONTACT

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