



## Chinese Government Issues Opinions on Construction Industry Development and Reform

On 1 July 2014, the Ministry of Housing and Urban–Rural Development (“MOHURD”) of the People’s Republic of China (“PRC”) released a document entitled “Several Opinions on Promoting Development and Reform in the Construction Industry” (住房城鄉建設部關於推進建築業發展和改革的若干意見 in Chinese) (the “Opinions”).

In the Opinions, MOHURD anticipates the evolution of the PRC national construction market in a “unified, open, competitive and orderly” manner. To this end, it proposes several rather significant strategies to consolidate national and regional construction policies, liberalise the domestic market and reform the industry as a whole. The emphasis of the Opinions is to promote the growth and enhancement of the industry by way of guaranteeing the quality and safety of projects, upgrading the level of engineering construction and responding to the most pressing issues in the contemporary PRC construction market.

Regional reaction to the Opinions has been generally positive. As at the date of this Commentary, several localities, including Gansu Province, Jilin Province, Ningxia Hui Autonomous Region, Shanghai City, Ningbo City, Nanning City and Xuchang City, have already drafted or published implementing regulations to enforce the Opinions in their respective regions or

cities. For example, Ningbo City has devised a pilot programme to implement the Opinions in three stages from February 2015 to June 2016, focusing on State-invested construction projects of residential buildings and infrastructure.

### The Establishment of a Unified and Open Construction Market

In order to unify the PRC’s construction legal regimes, MOHURD concludes that the national laws and regulations need to be made enforceable in all provinces and localities. In MOHURD’s view, every existing provision and practice that is not conducive to the formation of a unified and open national construction market and/or fair competition will be regarded as irregular and should be abolished. Examples of such irregularities include localised market entry barriers, bid collusion, price rigging, recontracting, affiliated contracting and illegal subcontracting. Accordingly, non-local enterprises should be permitted to freely access local construction markets and be immune from certain mandatory requirements, such as the obligation to incorporate local subsidiaries.

The Opinions call for the modernisation of the bidding supervision procedures, especially for non-state

invested projects. Projects should be awarded only to duly qualified contractors. Project owners should strictly adhere to the procedures for construction permits, quality and safety supervision. Market exclusion or unreasonable conditions attached to the bidding of state invested projects should be abandoned. Consequently, measures such as electronic bidding and bid submission, public announcement of bid winners and expert-led bidding systems should be introduced so as to enhance the openness and transparency of the entire bidding process. For example, Shanghai City has committed to implement a fully electronic bidding process by the end of 2015. MOHURD recommends that pricing should never be the sole consideration in determining a successful bidder.

Additionally, the Opinions state that the administrative examination and approval system must be reformed to shift the approach of construction qualification from one that places the emphasis on enterprise-based qualifications to one that focuses on practitioner-based qualifications. Existing qualification standards and administrative provisions for engineering construction enterprises are to be revised with certain categories being removed or merged. New qualification standards and criteria are to be formulated on the basis of credit standing, quality and safety of construction corporations as well as the professional qualifications of practitioners. The use of insurance and other market mechanisms will be encouraged to support the concept of “survival of the fittest” in the market.

To this end, MOHURD proposes that a unified national information database should be established for engineering enterprises, registered practitioners and parties to construction projects, to assist with the dissemination of regulatory and other relevant information. The pricing rules for different projects, industries and regions should also be standardised. In this context, Shanghai City aims to build an information database and a preliminary pricing management system by the end of 2015.

In the context of project management, the Opinions conclude that projects managed by qualified engineering consulting agencies should not be subject to state supervision. Further, the scope of projects subject to mandatory supervision should be revised. Accordingly, MOHURD proposes that certain regions should be selected to launch pilot programmes involving different models of supervision or other project management models.

The activities of project owners are to be more closely regulated so that they are held to account for any violations of standard procedures, such as entering into “ying-yang contracts” with contractors for tax evasion or other illegal purposes, shortening reasonable schedules or lowering reasonable project costs. The practice of splitting a project into several smaller parts should also be more tightly regulated. Finally, the involvement of cost consultants or quantity surveyors should be emphasized to provide better project cost control.

## **Reinforcing Project Quality and Safety Management**

The Opinions seek to strengthen the quality and safety aspects of project management through harmonising rules and regulations on survey and design quality. This will involve improving the quality inspection system and upgrading the safety supervision system. MOHURD concludes that a consolidated set of rules applicable to quality and safety control of construction projects should be established. Finally, the Opinions recommend the pilot implementation of project quality insurance to replace retention money. Shanghai City has committed to adopt such insurance for all state-invested projects by 2016.

## **Transforming the Development Model for the Construction Industry**

Through the Opinions, MOHURD is seeking to modernise the current development model for the PRC construction industry. The Opinions propose the adoption of a model based on engineering, procurement and construction (“EPC”) for engineering construction projects. To facilitate the use of the EPC model, public bidding will no longer be required for design and construction services to be provided under EPC contracts. The Opinions also advocate and promote the adoption of building information modeling (“BIM”) as part of the project design and life cycle process. In this regard, Shanghai City intends to formulate policies in favour of the use of BIM by the end of 2016 and to fully adopt BIM in all state-invested projects by the second half of 2017. All of this is intended to increase the technical capacity of the PRC construction industry.

Additionally, MOHURD advocates better use and efficiency of labour resources. With regard to the sourcing of technical

workers, the Opinions recommend that labour subcontracting should be the main source of employment, whereas labour dispatching should be seen as a temporary supplement. General contractors and specialised contractors should have a certain number of technical workers and should be encouraged to own or control construction labour service enterprises.

## **Strengthening of Organisation and Leadership for the Development and Reform of the Construction Industry**

The last section of the Opinions is devoted to reviewing the organisation and leadership of the PRC construction industry. It is recommended that government-invested projects should take a leading role in launching pilot schemes to formulate policy measures in accordance with the Opinions. Industry associations are simultaneously encouraged to set industry guidance and reference scales for non-state-invested projects.

## **Conclusion**

The thrust and substance of the Opinions will be welcomed by the many foreign participants in the PRC construction industry. The promotion of EPC contracting, and the emphasis on market-oriented mechanisms such as guarantees and insurance, bring the PRC construction industry more into line with international standards and norms. The abolition of market barriers should lead to a more transparent and competitive industry and a much more stable and consistent contracting approach across the whole country.

While much still remains to be clarified and no deadlines have been set, MOHURD should be congratulated on its far-sighted approach to reform, but as with so many things in the PRC, the actual and consistent implementation of the Opinions will be the real test.

## **Lawyer Contacts**

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