



Opportunity China – Construction Briefing

Ashley Howlett

Jones Day

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Introduction

- **Construction Industry in China**
- **Pre-WTO**
- **Current Regulatory Environment**
- **Construction (Decree 113 and Circular 159)**
- **Engineering and Design (Decrees 114 and 78)**
- **Project Management (Circular 200 and Decree 155)**
- **Competition**
- **The Future**

China Construction Facts

- *In 2006 construction output accounted for 5.6% of China's GDP*
- *Growth rate of Chinese construction sector from 2001 to 2006 was 22.2%*
- *Construction production value in excess of US\$600 billion in 2006*
- *By the end of 2007 China had 53,600 km of expressways, 20,000 km of which has been added since the end of 2004*
- *By 2020 the Beijing subway network will consist of 19 subway lines, with 561.5 km of track, Beijing will have the longest subway network in the world*
- *China consumes 30% of the world's steel output*
- *40,000 fingers are lost in machine accidents in the Pearl River Delta each year!*

The Construction Market in China

20 Largest Construction Markets in 2010			
		Construction Investment (in Billion USD)	Growth %
1	China	1,196.7	285
2	<i>United States</i>	958.5	32
3	Japan	916.3	35
4	<i>Germany</i>	598.0	89
5	<i>France</i>	302.2	88
6	<i>Italy</i>	273.5	111
7	<i>United Kingdom</i>	224.5	57
8	Korea	212.8	198
9	<i>Brazil</i>	201.5	240
10	<i>Spain</i>	187.5	103
11	<i>Canada</i>	127.9	79
12	Indonesia	120.1	567
13	<i>Mexico</i>	119.1	148
14	India	114.2	227
15	<i>Australia</i>	99.7	79
16	<i>Netherlands</i>	83.7	107
17	Thailand	71.1	427
18	<i>Belgium</i>	69.9	109
19	<i>Switzerland</i>	69.3	102
20	<i>Austria</i>	69.3	34

Design Institutes & Contractors

- *In 2006 there were 60,166 construction enterprises in China*
- *The total number of people employed by these 60,166 construction enterprises was 28,782,000*
- *45 Chinese contractors were included in the ENR list of the largest 225 international contractors in 2004*
- *Design Institutes are commonly industry-focused*
- *Traditional split between design and construction*
- *Design-Construct and Turnkey models are rare*
- *Quality and safety issues – supervision and management are key*

Pre-WTO

- **Foreign contractors only permitted access to the PRC via two paths:**
 - **JVs with PRC companies**
 - **By obtaining qualification certificates for specific projects (Decree 32)**
- **The first path largely still remains (via incorporated JVs with Chinese parties), but the second was phased out on July 1, 2005 (as per Decree 113 and Circular 159)**
- **Under Decree 32 market share of foreign contractors never exceeded 6%**

Current Regulatory Environment

- **Construction**
 - Decree 113 – Foreign-Invested Construction Enterprises (FICE) and Implementation Regulations
 - Circular 159 – Qualifications for FICE
 - Circular 159 Supplement - Qualifications for FICE
- **Engineering and Design**
 - Decree 114 - Foreign-Invested Design Enterprises (FIDE) and Implementation Regulations
 - Decree 78 – Offshore Design Regulations
 - Draft Qualification Regulations
- **Project Management**
 - Circular 200 – Project Management Regulations
 - Decree 155 – Foreign Invested Engineering Service Enterprise Regulations

Construction

- Decree 113 enacted on September 27, 2002
- Provides Regulations for establishment of FICE
- Provides for the repeal of Decree 32 from April 1, 2004 (subsequently extended until July 1, 2005 under Circular 159)
- Allows two access routes for FICE:
 - JVs with PRC companies with appropriate qualification certificate
 - Wholly Foreign-Owned Enterprises (WFOE) with appropriate qualification certificate
- There are no restrictions on the type of projects that FICE JVs can undertake in the PRC
- There are restrictions on the type of projects that FICE WFOEs can undertake in the PRC

Construction

- **FICE WFOEs only permitted to undertake the following types of project in the PRC:**
 - **Foreign-funded projects**
 - **Projects funded by international loans**
 - **Sino-foreign JVs where foreign investment is 50% or more, or where the foreign investment is less than 50% only on projects which require foreign technical expertise**
 - **Domestic funded projects which local contractor's cannot undertake because of technical difficulties, can undertake jointly with local contractors**

Construction FICE Qualification

- **Minimum registered capital requirements**
- **Minimum professional staff requirements**
- **Minimum residency requirements**
- **Track record (including outside China)**
- **Requires long term commitment to and investment in PRC market**

Registered Capital Requirements

General Contractor Capital Requirements

Qualification Category	Special Class RMB	Class 1 RMB	Class 2 RMB	Class 3 RMB
<i>Building</i>	300m	50m	20m	6m
<i>Highway</i>	300m	60m	30m	10m
<i>Railway</i>	300m	50m	20m	5m
<i>Electricity</i>	300m	70m	40m	20m
<i>Mining</i>	300m	50m	20m	8m
<i>Refining</i>	300m	50m	20m	N/A
<i>Chemical</i>	300m	60m	30m	N/A
<i>Civil</i>	N/A	40m	20m	5m
<i>E&M</i>	N/A	50m	20m	N/A

Professional Staff Requirements

Class 1 Building Contractor

- *General Manager must have 10 years construction management experience*
- *Chief Engineer must have more than 10 years engineering experience*
- *There must be at least 300 technical engineering and management staff of which at least 200 must be engineers, of these 200 engineers 10 must be senior engineers and 60 must be in a mid-level position*
- *There must be at least 12 Class 1 project managers*
- *The number of foreign service providers approved as project managers cannot exceed one third of the total number of project managers employed by the enterprise and each foreign service provider must stay in China for at least 3 months a year*

Scope of Work

Class 1 Building Contractor

- *Project value must not exceed 5 times the registered capital of the company*
- *Construction of buildings no higher than 40 storeys*
- *Construction of groups of buildings no more than 200,000 square metres*

Issues for Foreign Contractors

- *Projects limited to 5 times registered capital*
- *Projects essentially limited to foreign funded projects*
- *High registered capital requirements (RMB6m, 20m, 50m, 300m)*
- *High staffing requirements (50 technical or managerial personnel, 150, 300, 500)*
- *Subject to initial concessions for foreign contractors (Decree 159), qualifications start at the lowest level, but an application to upgrade qualifications can be submitted at any time, but must be supported by financial statements for the previous 3 years operations in China*

Engineering and Design

- Decree 114 enacted on September 27, 2002
- Provides Regulations for establishment of FIDE
- Allows two access routes for FIDE:
 - JVs with PRC companies with appropriate qualification certificate
 - Wholly Foreign-Owned Enterprises (WFOE) with appropriate qualification certificate
- Implementation rules came into effect in January 2007

Design FIDE Qualification

- **Minimum registered capital requirements**
- **Minimum professional staff requirements**
- **Minimum residency requirements**
- **Requires long term commitment to and investment in PRC market**

Registered Capital Requirements

General Engineering Design = RMB60m

Industry Engineering Design

Industry	Grade A RMB	Grade B RMB	Grade C RMB
<i>Chemical / Petrochem</i>	6m	3m	1m
<i>Oil & Gas</i>	6m	3m	1m
<i>Power</i>	6m	3m	1m
<i>Nuclear</i>	6m	3m	1m
<i>Construction</i>	6m	3m	1m
<i>Railways</i>	6m	3m	1m
<i>Highways</i>	6m	3m	1m
<i>Water</i>	6m	3m	1m



Professional Staff Requirements

- *General Engineering Design must have at least 500 technical professionals of whom at least 200 are certified architects or engineers*
- *Industry Engineering Design Grade A the Chief Engineer must have 10 years engineering design experience and have presided over engineering design for at least two major works*
- *There must be at least 38 engineers and 25 engineers for Chemical and Petrochemical industry Grade A and Grade B respectively*
- *There must be at least 49 engineers and 33 engineers for Oil & Gas industry Grade A and Grade B respectively*
- *The number of foreign service providers must not be less than 25% of the total staff and each foreign service provider must stay in China for at least 6 months a year – the Decree 114 Implementation Rules have relaxed these two requirements and allow a FIDE to employ Chinese service providers in lieu of foreign service providers on a “temporary” basis*

Foreign Design Enterprise Regulations

- Decree 78 effective June 10, 2004
- Apply to foreign enterprises that provide construction engineering design services inside China
- Such services include producing construction project-related preliminary design and working drawings or detailed design
- Regulations do not apply to any design that precedes preliminary basic design (i.e. conceptual design)
- Allow for collaboration with a Chinese design enterprise with appropriate qualifications on a project specific basis
- Collaboration does not have to be a joint venture
- Chinese enterprise must be a party to the contract with the owner

Issues for Foreign Designers

- *Restrictions on scope of design based on industry qualification*
- *High staffing requirements*
- *The number of foreign service providers must not be less than 25% of the total staff and each foreign service provider must stay in China for at least 6 months a year, although these restrictions have been relaxed under the recently released Decree 114 Implementation Rules*

Project Management

- Post 113 project management was the most common means of foreign contractor involvement
- But from December 1, 2004 project management is now regulated and qualifications apply
- Decree 155 regulates the establishment of foreign invested engineering service enterprise, which shall hold at least one of the supervision, tendering or cost advisory qualifications
- To qualify as a project management enterprise under Circular 200, you must hold a qualification certificate for any one of survey, design, tendering, construction, supervision or cost advisory
- Circular 226 recently issued by MOHURD in December, 2008 encourages the establishment of project management enterprises by large-scale engineering supervision enterprises, especially those with supervision qualification (at comprehensive and Grade A level), as well as tendering (at Grade A level) and cost advisory (at Grade A level) qualifications
- Protests from US and EU, but MOC has refused to change the requirements

Name Change: A New “Super Ministry”

- *On March 11, 2008, the government announced the creation of five new “Super Ministries”*
- *Pursuant to this announcement, the Ministry of Construction was transformed into the Ministry of Housing & Urban-Rural Development*
- *This change may indicate a transfer of final decision making powers for major construction projects from the central authorities to provincial governments and local city councils*
- *It is still unclear what, if any, impact the renaming of the Ministry of Construction will have*

Conclusion

- WFOEs allowed for the first time, but restricted
- No FIDE WFOEs until post December 2006
- The registered capital, staffing, residency and foreign national employment requirements are harsh (although now more relaxed for FIDEs)
- Project/construction management is now within the qualification regime
- Consortia take lowest qualification – not in line with international practice
- EPC contracting is only possible with Decree 113 and Decree 114 qualifications
- Acquisition of Chinese contractor or DI will need to be share transaction and will be subject to regulatory review
- Unpredictable regulatory system

Foreign Contractors and Designers

- **Aker Kvaerner – WFOE FICE**
- **Amec – WFOE FICE**
- **Balfour Beatty/Gammon – WFOE FICE**
- **Bechtel – WFOE FICE**
- **Bilfinger Berger - JV FICE**
- **Bovis Lendlease – WFOE FICE**
- **CH2M Hill – WFOE FICE**
- **Fluor – WFOE FICE (Grade 1) and WFOE FIDE (Grade A)**
- **Hong Kong Construction – WFOE FICE (Special Class)**
- **Jurong – WFOE FICE**
- **Keppell – WFOE FICE**
- **Samsung – WFOE FICE**
- **Technip – JV FIDE**
- **Toyo – WFOE FICE**
- **Worley Parsons – JV FIDE (Grade A)**

The Future

- Chinese construction sector changing from SOE to private
- Chinese contractors are “going out” and competing globally (often as a result of expertise gained from foreign contractors)
- International contractors must focus on niche and high value sectors in China:
 - Energy
 - Tunneling
 - Environmentally friendly projects
 - Desalination, waste incineration
 - Project Management
- Increased interest in EPC and CM forms of procurement
- Continued “protection” of Chinese architects
- 2009 promises to be a challenging year