China: Construction

This country-specific Q&A provides an overview of construction laws and regulations applicable in China.

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1. Is your jurisdiction a common law or civil law jurisdiction?

   China is a civil law jurisdiction.

2. What are the key statutory/legislative obligations relevant to construction and engineering projects?

   Key statutory obligations relevant to construction and engineering are set out in Construction Law (newly amended in 2019), Law on the Administration of the Urban Real Estate, Law on Urban and Rural Planning (newly amended in 2019), Law on Bid Invitation and Bidding, Law on Government Procurement etc. Among them, Construction Law stipulates various requirements relating to the construction permit, qualifications, contracting mode, engineering supervision, safety construction management, quality management etc. throughout construction and engineering projects.

3. Are there any specific requirements that parties should be aware of in relation to: (a) Health and safety; (b) Environmental; (c) Planning; (d) Employment; and (e) Anti-corruption and bribery.

   Health and safety

   Law on Work Safety and administrative regulations promulgated by State Council such as Regulations on Administration of Construction Safety, Regulations on Safe Work Permits specifically provide for that all parties to construction and engineering projects shall observe the provisions of the laws and regulations on work safety, ensure construction safety, and assume the responsibility in terms of construction safety according to law.

   Environmental issues

   The Ministry of Ecology and Environment of PRC is the main body that enforces the anti-pollution laws, which include Environmental Protection Law, Law on Environmental Protection Tax, Law on the Prevention and Control of Atmospheric Pollution, Law on Prevention and Control of Water Pollution Law on Environmental Impact Assessment Control, Law on Promotion of Cleaner Production. Other important administrative regulations regarding environmental issues include Regulations on Environmental Protection Management for Construction Projects

   These laws manifest that compliance with environmental laws and regulations are vital to every stage of a construction and engineering project, from commencement of work and construction management to inspection and taking over. These laws and regulations encourage operators not to pollute, and to provide a framework for offenders to be punished. Penalties generally include fines, suspension of projects and provisions for jail terms.
Planning

According to Law on Urban and Rural Planning (newly amended in 2019), prior to commencement of development, the developing entity shall apply for a permit for a planned construction project to the department in charge of urban and rural planning. Upon completion of a project, the department in charge shall check whether a construction project is in compliance with the conditions for planning. If a construction project is not checked, or checking proves that it does not comply with the conditions for planning, the developing entity may not arrange for acceptance check upon completion of the project.

Employment

Any employment involved in a construction and engineering project shall comply with Labor Law, a law formulated in accordance with the Constitution with a view to safeguarding laborers’ lawful rights and interests. For the purpose of regulating wage payment to migrant workers and ensuring that migrant workers receive their wages on time and in full, a new Regulation on Ensuring Wage Payment to Migrant Workers has been issued and will come into force on May 1, 2020, in which a separate chapter stipulating special provisions on engineering construction has been introduced and shall be followed in construction projects.

Anti-corruption and bribery

Criminal Law outlaws corruption and bribery in both the public and private sector and Law on Bid Invitation and Bidding and Law on Government Procurement specifically prohibits corruption during selection stage in construction industry. For prevention of corruption and bribery by any public functionaries who exercise public power, there is the newly published Supervision Law of the PRC, as well as Law on Public Servants.

4. What permits/licences and other documents do parties need before starting work, during work and after completion? Are there any penalties for non-compliance?

Examples of licenses/permits that are required to be applied for are as follows:

1) before starting work: construction land use permit, permit for a planned construction project, construction permit;

2) during work: no special licences required;

3) after completion: EIA acceptance, registration of acceptance and inspection.

Penalties for non-compliance generally include a fine, suspension of construction, ordered restoration and refusal on acceptance and inspection registration.
5. Is tort law or a law of extra contractual obligations recognised in your jurisdiction?

Yes, tort law is recognised in China, tort liabilities are specifically set out in Tort Liability Law.

6. Who are the typical parties to a construction and engineering project?

The typical parties in an engineering construction project include the owner, survey and investigation institution, designer, constructor, materials and equipment supplier, supervisor, cost consultant and other consultants.

7. What are the most popular methods of procurement?

In China, the traditional design-bid-build (DBB) method is commonly used in building construction, and the general contracting method, which includes

Engineering, Procurement and Construction (EPC) and design-build (DB), is more popular for energy and petrochemical projects. Yet considering the government’s strong advocacy of general contracting, and Measures on General Contracting for Construction of the House Building and Municipal Infrastructure Projects being promulgated by the National Development and Reform Commission (“NDRC”) and the Ministry of Housing and Urban-rural Development (“MOHURD”) has come into force on March 1st, 2020, it is believed that before long the general contracting method will have an extensive application on China’s construction market, especially in state-funded projects.

8. What are the most popular standard forms of contract? Do parties commonly amend these standard forms?

There are three main standard form contracts in use on the market: (1) legally required standard contracts: for a project where bidding is required by law, the standard contract form produced by the NDRC shall be adopted; (2) standard contracts made by housing and urban-rural development departments: other than the standard contracts made by the NDRC, the MOHURD and the housing and local urban-rural development departments have their own set of standard contracts recommended for employers; (3) third party standard contracts: besides the foregoing, it is common practice that foreign invested employers use FIDIC contracts or other standard contracts composed by a third party, in which respect the broad application of FIDIC contracts dwarfs that of AIA, NEC or JCT contracts.

Today, the Chinese construction market is still dominated by employers, causing the competition among contractors to become ever intense. Consequently, from the perspective of risk allocation, employers are in a distinctively advantageous situation compared to contractors. The foregoing three standard forms of contracts, on the other hand, differ in terms of stipulation of risk allocation. FIDIC contracts place more emphasis on equality and reasonableness, while the contracts produced by NDRC and MOHURD have a partiality
towards contractors in terms of protection of interests due to the power imbalance between employers and contractors. As a result, the employer tends to make considerable adjustment to the standard contract by wielding its market dominance. Nevertheless, in case of a project that is required by law to invite bids, if the contract as amended provides too much preference to employers, the competent construction authority, in order to participate in and regulate risk allocation, will require contractual parties to make further change, otherwise such contracts will not be accepted to keep record with the authority as required by law.

9. **Are there any restrictions or legislative regimes affecting procurement?**

If the procurement of equipment, materials or other items relating to the survey, investigation, design, construction, supervision and general engineering works of the project reaches certain standards set out in law (for example, the estimated contract price for a single construction item exceeds RMB 4 million), the following projects, must be put out to tender pursuant to applicable law: (1) projects fully or partially funded or financed by the state, or having accepted loans or financial aid from international organizations or foreign government, (2) projects that relate to social or public interest or public security.

10. **Do parties typically engage consultants? What forms are used?**

According to applicable laws and regulations, for projects that require supervision in accordance with law, employers must engage a supervisor to manage the quality and safety of the project. Apart from the supervisor, employers will also engage cost consultants to provide services regarding the project cost. Moreover, for employers lacking real estate development experience, employers may further engage a project manager to provide management service and consulting for, among other things, the term, cost, quality and safety of the project.

In the meantime, the government is promoting full-service project consulting, where a consulting firm provides consulting services for all aspects of the project encompassing survey, design, construction period, costs, quality, safety, so on and so forth, in which case employers will not need to recruit any surveyor, designer, supervisor, cost consultant or other consultants separately.

11. **Is subcontracting permitted?**

Subcontracting an engineering construction project is allowed in China with certain limitations to the range of projects. According to applicable laws and regulations, the construction of the main structure (excluding steel structure) shall be completed by the general contractor singlehandedly and shall not be subcontracted. What’s more, subcontractors may further subcontract the labour works to others but are not allowed to subcontract any other non-labour works and shall complete such non-labour works on their own.
12. How are projects typically financed?

Currently, the construction projects in China are typically financed through: (1) bank loans or non-bank financial institution loans; (2) intercorporate borrowings; (3) issuance of bonds; (4) asset-backed securities; (5) PPP structure (including BOT and TOT); (6) government funding.

13. What kind of security is available for employers, e.g. performance bonds, advance payment bonds, parent company guarantees? How long are these typically held for?

The type of security available for employers include without limitation to performance bonds, advance payment bonds and parent company guarantees. Employers and contractors will agree on the term of such bonds or guarantees, regarding which it is usually stipulated that the term of a performance bond will expire on the date when project is completed and accepted and a taking-over certificate issued by employer, the term of an advance payment bond will not expire until all amounts paid in advance have been paid back, and the term of a parent company guarantee will expire on the date when construction is completed and accepted and a certificate of completion and acceptance is issued by the owner.

14. Is there any specific legislation relating to payment in the industry?

There is no specific legislation with respect to the payment milestones or percentage for the construction price. Employers may make their own decision based on their business demands. Yet it should be noticed that if employers’ payment schedule is significantly behind the actual work completed by contractors, there may be a risk of “construction before payment”. Therefore, in judicial practice, it takes further consideration of relevant contract terms to determine the nature of relevant amounts, which may be an overdue construction payment or loan repayment. In addition, Regulation on Ensuring Wage Payment to Migrant Workers requires that labor costs needs to be separated from the other construction funds and the employer shall make payment to the dedicated account for migrant workers’ wages at least on a monthly basis.

15. Are pay-when-paid clauses (i.e clauses permitting payment to be made by a contractor only when it has been paid by the employer) permitted? Are they commonly used?

Pay-when-paid clauses are permitted by law and are rather common in construction subcontracting contracts. In practice, pay-when-paid clauses are normally considered as conditional legal acts where general contractors may have to bear the majority of burden to prove “conditions not met” if it fails to make payment to the subcontractor.

16. Do your contracts contain retention provisions and, if so, how do they operate?

In China, the construction contract templates often contain retention clauses, which, in
particular, includes: (1) the total amount, which shall not exceed 3% of the engineering settlement price; (2) the form, which may be set out as a letter of guarantee for retention, or an amount retained from the construction price; (3) the term, in which it is usually stipulated that the retention will be returned within 2 years after passing completion provided that the contractor undertakes the warranty obligation (namely upon expiration of the defect liability period). Whether such retention shall accrue interest or not is left for both contractual parties to negotiate and decide.

17. Do contracts commonly contain delay liquidated damages provisions and are these upheld by the courts?

It’s common practice that the parties may stipulate liquidated delay damages payable upon contractor’s delay for certain agreed milestones. As long as the contract is valid and such liquidated damages are commensurate to the loss incurred, the judicial practice tends to uphold such provisions. Where a party demands a reasonable decrease of an obviously high liquidated damages (i.e. the agreed liquidated damages exceeds 30% of the incurred loss according to judicial interpretation of the Supreme Court), the court will review under the principles of fairness and good faith by comprehensively considering the factors of the actual loss, the contract performance, the party’s degree of fault and the anticipated profit.

18. Are the parties able to exclude or limit liability?

Yes, and the most common provision is the one that limits the amount of damages. Generally, if such provisions are made out of the real and free intention of the parties and do not contravene the mandatory provisions of laws and administrative regulations, public policy and public interests, the judicial practice usually tend to uphold their validity. In addition, if a party takes advantage of its superiority or the other party’s lack of experience and cause the rights and obligations of the parties set out in a contract are apparently unequal or not for valuable consideration, the contract may be deemed as obvious unfair, and a party may claim for cancellation of the contract.

19. Are there any restrictions on termination? Can parties terminate for convenience? Force majeure?

The parties can stipulate a termination for convenience provision in a contract and according to the Chinese law, the parties are entitled to terminate the contract in case the purpose of the contract is rendered impossible to achieve due to a force majeure event. Where the law provides for or the parties agree upon a time limit for the exercise of termination, parties need to exercise termination right within such time limit, otherwise, the said right may be extinguished.

20. What rights are commonly granted to third parties (e.g. funders, purchasers, renters) and, if so, how is this achieved?
In some customized projects, the employer may grant purchasers, renters or the actual users of the project to review or approve the drawings or specifications, and the financing parties may, to some extent, be entitled to review the payment schedule and supporting documents. Such authorization is usually agreed by the parties under contract and such practice is often case by case subject to the parties’ bargain and negotiation.

21. **Do contracts typically contain strict provisions governing notices of claims for additional time and money which act as conditions precedent to bringing claims? Does your jurisdiction recognise such notices as conditions precedent?**

The parties to a construction contract normally agree a time period for claims to prompt a party to exercise its rights in a timely manner. However, where a party whose claim is rejected by the other party because of failure to bring the claim within the notification period may still be entitled to bring a case to a court or arbitration institution within the statutory limitation of action. The judicial practice may tend to look into the actual facts and may not easily deprive the rights of the parties and may still entitle claims for additional time and money upon failure to give notice.

22. **What insurances are the parties required to hold? And how long for?**

It’s general practice for construction contracts to require all-risks insurance (usually until project completion), work-related injury insurance for migrant workers, accident insurance for personnel dealing with dangerous operations, professional liability insurance, cargo transportation insurance, and stored goods insurance. Among the above, work-related injury insurance and accident insurance for personnel dealing with dangerous operations are compulsory under law. Moreover, most of the foregoing insurances are also required by the local legislations or local regulatory documents where the project is located.

23. **How are construction and engineering disputes typically resolved in your jurisdiction (e.g. arbitration, litigation, adjudication)? What alternatives are available?**

Typical dispute resolution mechanisms for construction and engineering disputes are litigation and arbitration. The adoption of alternative dispute resolution (“ADR”) is still a rare scene in the Chinese market – only a few foreign-related cases resorted to expert evaluation. Some arbitration committees are trying to establish and introduce in similar mechanisms, but it is still in its infancy and is very immature.

24. **How supportive are the local courts of arbitration (domestic and international)? How long does it typically take to enforce an award?**

Local courts have always been a strong support to enforcing domestic arbitration awards. In 2018, the Supreme People’s Court released Provisions of the Supreme People’s Court on Several Issues Concerning the Handling of Cases by People’s Courts to Enforce Arbitration Awards.
Awards, providing further comprehensive systematic assurance and support for the enforcement of arbitration awards.

In respect of international arbitration, China is a member state to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (“New York Convention”) and China acknowledges and enforces the arbitration awards issued in the territory of another member state pursuant to New York Convention. Nevertheless, the New York Convention also provides that if a court believes the dispute cannot be resolved through arbitration according to the applicable law in the place where such arbitral award is to be recognised or enforced, or the recognition and enforcement of the arbitral award will violate any local public policies, the court is entitled to reject the enforcement of such arbitral award.

In addition, given the special relationship between mainland China, Hong Kong Special Administrative Region and Macau Special Administrative Region, the recognition and enforcement in mainland China of arbitral awards conferred by arbitration institutions in Hong Kong and Macau is governed by the Arrangements of the Supreme Court on the Mutual Enforcement of Arbitral Awards between the Mainland and the Hong Kong Special Administrative Region and the Arrangement of the Supreme Court on Mutual Recognition and Enforcement of Arbitral Awards Made in the Mainland and Macau SAR, the composition of which draws on the principles in New York Convention.

If one party fails to enforce the award, other entitled parties may apply to a court for enforcement, the term of which, theoretically, is six months following the receipt of the foregoing application for the enforcement by the relevant court. In practice, however, this regulation about enforcement term is not always observed, in which case, the applicant may apply for enforcement to a court of higher level and such higher level court may instruct the award to be enforced within given time, but such time given for enforcement has no specific limitation in law. At the same time, as respondents often apply for revocation of the award or non-enforcement of the award in order to delay the procedures, the enforcement of an arbitral award may sometime take forever.

25. Are there any limitation periods for commencing disputes in your jurisdiction?

According to Article 188 of General Provisions of the Civil Law, the statute of limitations for an application to a people’s court for protection of civil rights is three years. Such limitation period shall start calculation from the date on which the right holder knows or should be aware of the damage to the right and the obligor, and the people’s court will not grant any protection to such rights upon the expiration of 20 years from such date of damage. Additionally, there are special regulations regarding statute of limitations for matters specifically stipulated in law, which includes, for example, disputes with respect to international sales of goods contracts and technology import and export contracts (the statute of limitations for disputes regarding the foregoing two kinds of contracts is four years).
According to Article 74 of the Arbitration Law, unless otherwise specially provided by law, statute of limitations provisions shall apply to arbitration proceedings. The application of arbitration-specific time limits is uncommon, thus, in most cases, the time limit for arbitration claims stays the same as statute of limitations.

26. **How common are multi-party disputes? How is liability apportioned between multiple defendants? Does your jurisdiction recognise net contribution clauses (which limit the liability of a defaulting party to a “fair and reasonable” proportion of the innocent party’s losses), and are these commonly used?**

   Multi-party disputes are very common in China’s legal practice. In case of multiple defendants, liabilities will be allocated among defendants to the extent each defendant bears its own due legal liabilities according to law.

   “Fair and reasonable” clauses (or net contribution clauses) are not widely accepted in China’s business contracts, especially in construction contracts. Since owners in China are much more powerful, and the construction contracts are usually drafted by them, owners tend to ask contractors to be fully responsible for all liabilities relating to losses and even set out rather expensive liquidated damages. In the event that the liquidated damages are unreasonably higher than actual losses (exceeding the actual loss by 30% or above), the court may confer to reduce the liquidated damages based on the actual loss and in consideration of contract performance situation, degree of fault of the defaulting party, expectation loss and other relevant factors.

27. **What are the biggest challenges and opportunities facing the construction sector in your jurisdiction?**

   We believe the biggest challenge in Chinese construction industry is, among other things, the uncertainty or slowdown of social and economic development. The rapid development we experienced in the past mainly attributes to the significant increase in fixed-asset investment, but the evolution of Sino-US trade war and other events have instilled unignorable uncertainties in China’s economic growth, casting shadow on the construction industry’s development prospects, outdating the old speed-oriented development model that relies on massive investment, incessant financing and uncalculated expansion. Adding to that are higher environmental protection standards posed by the ever more strict state environmental policy on construction companies in various aspects including processes and cost control. In addition, with China’s labour surplus draining out, the number of workers in the industry declines year by year, giving rise to the frequent “labour shortage” all over China at the outset of each year.

   Regardless of the foregoing challenges, China’s construction industry is also met with multiple opportunities:

   [1] Chinese government is pushing forward the reform of construction project review
processes and construction industry qualification management, streamlining administration and delegating more power to lower-level governments, reducing approval procedures, lowering the corporate qualification requirement for construction companies and strengthening supervision on individual practice.

The Belt and Road Initiative has brought plenty of new opportunities. In recent years, Chinese construction and engineering companies have picked up strong momentum in overseas markets, but against the backdrop of the unstable international environment where the competition among major economies have escalated, for Chinese companies abroad, it is bound to be a tumbling journey with challenges and opportunities intertwined.

It needs to be illustrated that, as affected by the novel coronavirus outbreak, the output value and revenue of the construction industry in the first quarter of 2020 may be highly affected. Nevertheless, the first quarter is always the slack season of construction industry due to Chinese Spring Festival and unfavourable winter conditions, and the affected projects may catch up in the following quarters through acceleration. As China appears to have the virus under control, local projects gradually resume to work. In the medium and long run, since the novel coronavirus outbreak has a relatively huge impact on China’s economy in the first quarter, the demand for infrastructure investment to play the role of counter-cyclical adjustment will be more urgent. Under the requirement that investment plays a role in stabilizing growth, the current policies and funds will both favourably support China’s construction industry to run smoothly. Therefore, the negative impact on the construction industry may be relatively minor. However, since the spread of the virus continues more globally, it may bring more negative impact to the development of China’s overseas construction industry.

28. **What types of project are currently attracting the most investment in your jurisdiction (e.g. infrastructure, power, commercial property, offshore)?**

Each year in the past few years, as an important stable investment tool to achieve steady profit growth, infrastructure investment accounted for over 20% of yearly total fixed-asset investment, serving as a main powerhouse to China’s construction sector. Specifically, investment in new infrastructure projects, presented by 5G networks, artificial intelligence (AI), industrial internet, and internet of things, is expected to boom in the next few years.

On the other side, real estate investment has been extremely popular in China for years. In 2019, real estate investment exceeds 20% of the total fixed-asset investment, of which residential real estate investment accounted for almost 70%.

29. **How do you envisage technology affecting the construction and engineering industry in your jurisdiction over the next five years?**

Technology plays an increasingly important role in construction engineering. Among China’s
construction projects, the use of Building Information Modelling ("BIM") system is gaining increment on a daily basis. In addition, the construction of the Huoshenshan Hospital and Leishenshan Hospital made full use of building industrialization’s advantage. Prefabricated construction is expected to be greatly developed in China.

BIM and prefabricated construction, two technological breakthrough, will lend great assistance in solving Chinese construction sector’s long-lasting problems in construction efficiency, quality safety, and cost control, facilitating the upgrading and transformation of the traditional construction sector.