

New Rules on Establishing Construction Project Services Enterprises in China Will Create Investment Opportunities for Foreign Investors

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Introduction

1. On 19 September 2005, the PRC Ministry of Construction (“MOC”) issued a draft of the Administrative Regulations on Foreign-invested Construction Project Services Enterprises (the “Draft Regulations”) in order to solicit public comments. The deadline for submitting comments is 15 October 2005.
2. Since China’s accession to the World Trade Organisation (“WTO”), the MOC has issued Decrees 113, 114 and 116 in order to create regulatory paths for foreign investors to establish foreign-invested enterprises (“FIEs”) to engage in construction works, engineering, construction design and urban planning activities in China. The Draft Regulations will supplement the existing PRC construction regulatory regime, and will widen the range of construction industry sectors in which foreign investors are permitted to set up local entities. If the Draft Regulations are issued in their current form, after 11 December 2006, foreign contractors will be permitted to establish FIEs to engage in the provision of construction supervision, tendering agency and cost surveying services.
3. For the purpose of understanding the Draft Regulations, we have set out below an overview of the Draft Regulations and our comments on the Draft Regulations.

Primary contents of the Draft Regulation

4. Article 2 defines the basic scope of application of the Draft Regulations: they apply to the establishment of foreign-invested construction services enterprises in China and to applications for qualifications by such foreign-invested construction services enterprises. According to Article 3, “Construction Project Services Enterprises” refers to construction project supervision enterprises, construction project



tendering agencies and construction cost surveying enterprises. Article 3 of the Draft Regulations further states that Foreign-invested Construction Project Services Enterprises may take the form of Sino-foreign equity joint ventures (EJVs), Sino-foreign co-operative joint ventures (CJVs) as well as wholly foreign-owned enterprises (WFOEs). In other words, the whole range of traditional foreign direct investment vehicles are available. It is important to note, however, that the Draft Regulations provide that in the case of EJVs and CJVs, the Chinese investor must hold at least 25% of the equity interests.

5. Pursuant to Article 4 of the Draft Regulations, the procedures for foreign investors to set up Foreign-invested Construction Project Services Enterprises involve obtaining the Foreign-invested Construction Service Enterprise Approval Certificate issued by the relevant Ministry of Commerce (“MOFCOM”) authorities and then filing an application for registration with the relevant Administration of



Industry and Commerce (“SAIC”) to obtain a PRC business licence. Subsequently, the Foreign-invested Construction Project Services Enterprise must proceed to apply to the competent construction authorities under the MOC for the corresponding construction project services qualification.

6. As with entities created pursuant to MOC Decrees 113 and 114, the Draft Regulations outline a two-step approval process. Pursuant to the relevant provisions in the Draft Regulations, the establishment of Foreign-invested Construction Project Services Enterprises is subject to the approval of the MOFCOM authorities, who must seek the opinion of the relevant MOC authorities.
7. As with the procedures specified in MOC Decrees 113 and 114, the establishment approval and subsequent qualification application procedures are administered by MOFCOM and MOC at different hierarchical levels, depending on the grade of qualification applied for by the to-be-established Foreign-invested Construction Project Services Enterprise. If the entity seeks a Grade A qualification, the MOFCOM and MOC authorities at the central level will be responsible for issuing the establishment approvals and dealing with the subsequent qualification application. However, if the entity only applies for a Grade B or a lower grade of qualification, it will be the local MOFCOM and MOC authorities at the provincial (or equivalent) level that will be involved in the establishment and qualification approval process.

New path to project management (PM) works

8. According to the Draft Regulations, Foreign-invested Construction Project Services Enterprises are, after establishment, required to apply for the relevant construction project services qualification. As with MOC Decree 113 and 114 entities, Foreign-invested Construction Project Services Enterprises

must comply with the same qualification requirements as are applicable to domestic Chinese construction project services enterprises. This “level playing field” rule has created grave concerns among foreign investors with respect to MOC Decree 113 entities set up by foreign investors, given the onerous registered capital requirements for higher grades of construction works qualifications. Although a MOC Decree 114 entity has a much lower registered capital requirement, as compared to a MOC Decree 113 entity, applications for formation of MOC Decree 114 entities have not been accepted to date by MOC, ostensibly due to the absence of any Implementing Rules for MOC Decree 114.

9. In general, as compared with MOC Decree 113 or 114 entities, a Foreign-invested Construction Project Services Enterprise is subject to less challenging qualification requirements. For example, the minimum registered capital requirement for a Grade A construction supervision company, tendering agency or construction cost surveying enterprise is only RMB 1 million (equivalent to USD 123,300), which is one attractive feature for foreign investors.
10. The Draft Regulations may also provide a useful “back door” route for foreign investors to engage in project management (“PM”) services on China projects depending on the content and timing of promulgation of pending amendments to the PRC Construction Law. According to MOC Decree 200, foreign enterprises or even FIEs are not allowed to provide PM services in China unless they hold one or more of the “six qualifications”: namely those relating to surveying, design, construction works, construction supervision, cost surveying or tendering agency. Until the Draft Regulations are promulgated, foreign investors will only be able to obtain construction works or engineering design qualifications, by means a Decree 113 or 114 entity. If the Draft Regulations are passed in the current form, foreign enterprises will have a wider choice as to the type of vehicle they can use to meet their business objectives by performing other construction-related services in China.

Timeframe

11. It is important to note that Article 18 of the Draft Regulation provides that applications for the establishment of Foreign-invested Construction Project Services Enterprises will not be accepted until 11 December 2006. This is in line with China's WTO commitments. According to China's WTO accession commitments, construction-related services industries will be opened to foreign investment five years after China's accession to the WTO.

Conclusion

12. In conclusion, the circulation of the Draft Regulations can be seen as a positive step in the direction of further opening up the PRC engineering and construction market to foreign investment. Compared with MOC Decree 113 and 114 entities, Foreign-invested Construction Project Services Enterprises will have the lowest minimum investment of all the construction-related foreign investment vehicles, and will provide spin-off benefits in terms of rights to engage in PM. The only downbeat aspect of the Draft Regulations is the long lead time between now and December 2006. However MOC should be commended for its transparency and for giving potential foreign investors a foretaste of the changes to the regulatory regime ahead, so that they can plan their China businesses accordingly.

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