

# Issues of Affiliation in the Engineering Industry

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## ABSTRACT

Due to the implementation of the enterprise qualification management system in the engineering industry in China, there are certain requirements for the construction companies that undertake projects. However, in practice, many projects do not have high requirements for construction capabilities, and even those who don't have corresponding qualifications can complete the construction of the project and meet the quality requirements. This has led to a large number of construction companies that do not meet the qualification requirements and even construction teams composed of natural persons borrowing the names of other enterprises to undertake projects. Although it is expressly prohibited in legislation, it can't be stopped completely in practice. This paper will analyze the causes of this phenomenon and propose improvement suggestions, in order to promote the long-term healthy development of the engineering industry.

## KEYWORDS

Affiliation; Qualification Borrowing; Engineering.

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## 1. INTRODUCTION

Affiliation is a term used in engineering practice, not a legal term. The core connotation of affiliation is to "borrow qualifications" to undertake projects, which violates the prohibitive regulations of laws and regulations on construction quality safety and qualification management. After being affiliated, the lender often becomes a "disposable shopkeeper", which can easily lead to the qualification management system in name only and the project quality difficult to guarantee, so civil legislation, administrative legislation and the judiciary hold a negative attitude towards affiliation of construction projects.

However, the phenomenon of affiliation business has not disappeared, but has intensified in the long economic river. The reason is that affiliation business has its suitable living conditions in China: with the acceleration of urbanization, an increasing number of construction projects need a large number of construction forces to complete, while the number of qualified construction enterprises in China's construction market is short, and there are a lot of loose construction organizations composed of labor contractors and migrant workers in the market, which can bridge the gap in construction forces. How to ensure project safety while conforming to the decisive role of market in resource allocation is worth deep consideration.

## 2. CURRENT SITUATION OF AFFILIATION

### 2.1. Legislative Status

According to Article 10 of the 2014 Trial Implementation of the Administrative Measures for the Identification and Investigation of Illegal Subcontracting and Other Illegal Acts in Construction

Engineering, "Affiliation" refers to "the act of a unit or individual undertaking a project in the name of another qualified construction unit". In practice, the general situation is that construction enterprises without qualifications or with lower-level qualifications borrow the name of qualified enterprises to undertake projects in order to meet engineering requirements. Even higher-level qualified enterprises borrow the name of lower-level qualified enterprises, however, this situation is generally due to the fact that the enterprise has become a dishonest person subject or has been included in the bidding blacklist, rather than to avoid the requirement for qualifications; and the borrower needs to pay a certain proportion of management fees to the lender, and the lender has the obligation of organization, assistance, consultation, but in fact, all construction-related matters are basically handled by the borrower. Article 26 of Construction Law of the People's Republic of China stipulates that "It is prohibited to undertake projects in the name of any other construction enterprise in any form, and it is prohibited for construction enterprises to allow other units or individuals to use their qualification certificates and business licenses in any form to undertake projects in their own name"; Article 66 stipulates that "If a construction enterprise transfers or lends its qualification certificate or allows others to undertake projects in its own name, it shall be ordered to make corrections, confiscated of illegal income, and fined. It may also be ordered to suspend business for rectification and reduce the level of qualification; if the circumstances are serious, the qualification certificate shall be revoked. For losses caused by the fact that the contracted project does not meet the required quality standards, the construction enterprise and the unit or individual using its name shall bear joint and several liability for compensation.

However, despite the explicit prohibition of affiliation in the law and the provision of different levels of disciplinary measures, the phenomenon of affiliation still persists in practice.

## **2.2. Judicial Status**

There are three different views on the effectiveness of the construction contract signed by the borrower in the name of the lender with the employer.

One view is that the effectiveness of the contract should be determined based on the qualifications of the borrower. If the borrower has the corresponding qualifications for the construction project, the contract is valid. If not, it is invalid. The reason is that "although the borrower has the corresponding construction qualification level, but due to other reasons, it adopts the method of borrowing qualifications to undertake the project, which is actually sufficient to ensure the quality and safety of the project, does not harm the public interest, does not violate the normative purpose of the construction enterprise qualification management system, and should not deny the effectiveness of such affiliation construction contracts." After the promulgation of Civil Code of the People's Republic of China, some people believe that "it is noteworthy that since this article allows the employer to request the borrower who has no contractual relationship with it to bear joint and several liability for breach of contract, it actually implies the recognition of the effectiveness of the construction contract formed by affiliation." The further reason for this view is that, the second term of Article 1 of the 2004 Judicial Interpretation on Construction Projects stipulates that "unqualified actual builders borrow qualified construction enterprises", which does not include situations where qualified actual builders borrow the name of a construction enterprise to sign construction contracts.

The second view is that the subjective psychological state of the employer should be used as the criterion for determining the validity of the contract. If the employer is aware of affiliation, it is invalid. If not, it is valid. The reason is that this behavior is highly concealed, and if the subjective psychological state of the employer is not identified, it is easy to completely leave the judgment of the validity of the contract to the lender. If you want to prove that the construction agreement is invalid, the lender will take out the affiliation agreement. Otherwise, the lender will conceal the agreement. "However, if the construction contract is invalid, there is no way to talk about the breach

clause, and the employer cannot hold the lender liable for breach of contract, which poses a huge legal risk to the employer and always puts the employer in a passive position."

The third view is that the construction contract between the lender and the employer is invalid, regardless of whether the lender has the corresponding construction qualifications or whether the employer is aware of the affiliation. The reason is that the affiliation behavior violates the mandatory provisions of relevant laws and regulations such as the Construction Law, and therefore the construction contract should be invalid.

### **2.3. Law Enforcement Status**

In order to understand the current situation of administrative penalties imposed by administrative functional departments on affiliation, this paper conducted in-depth interviews with an official who have been engaged in this business for a long time. The main content of the interview is as follows:

Regarding the issue of the number of cases of affiliation being investigated and punished. The phenomenon of affiliation is widespread. It is estimated that nearly half of the projects in the current jurisdiction involve affiliation, but the number of affiliation investigated and dealt with is not high. Before 2018, the administrative penalty power of the city's affiliation was held by the Construction Bureau, and the number of affiliation cases investigated and dealt with was only over 10 per year.

As regards the reasons for the small number of investigations and punishments. From the perspective of investigation and punishment methods, the main ones currently include superior supervision, self inspection, and reporting. There are few cases supervised by superiors, and self inspection mainly includes special inspection, random inspection, quality and safety tracking. Special inspections cannot be carried out frequently, and the scope of random inspections is limited. Although quality and safety tracking theoretically runs through the entire construction process, the actual situation is that the number of supervisors responsible for quality and safety tracking is extremely short. Taking the municipal bureau as an example, there are only a few supervisors at the county and district levels, and it is obviously unrealistic to track the entire process of numerous projects of all sizes in the market. Although there are channels for reporting, the actual number of reports received is very small.

The last is the feasibility of administrative penalties. If corrective measures are ordered, such as issuing a cease-work order, it will delay the construction progress, especially for major projects. However, if only fines are imposed, how to punish is also a major problem. In practice, the amount of fines is too small, which will affect the effect of punishment; while too much fines will affect the development of enterprises and may even lead to business closures, which is not conducive to optimizing the business environment.

## **3. ANALYSIS OF CAUSES**

### **3.1. Market Driven**

China implements a strict qualification management system. The Regulations on the Administration of Construction Enterprise Qualifications strictly divide the qualification categories and standards. For example, there are 12 categories in the general contracting sequence of construction, which are generally divided into four levels; there are 36 categories in the professional contracting sequence, which are divided into three levels. The Construction Law also clearly stipulates that enterprises engaged in construction activities must be within its qualification level. It can be seen that qualifications are like admission tickets to the construction contracting market, and those without qualifications are difficult to enter the market.

However, in recent years, with the acceleration of urbanization and the continuous investment of the state in infrastructure construction, the construction industry has developed rapidly. Compared with

the total demand of the domestic market, the number of large construction enterprises with qualifications and capabilities is still in short supply, which objectively makes it difficult to digest the huge domestic market. While a large number of construction teams and personnel in China's construction market do not have corresponding qualifications and need to rely on affiliation to maintain their livelihood. Affiliation has its suitable living soil, which inevitably leads to a large number of units and even individuals without corresponding qualifications entering the construction market. The unbalanced supply-demand relationship will give rise to illegal business forms such as affiliation.

### **3.2. Difficult to Investigate**

Although the current rules have the ambition to regulate affiliation, there are many factors that hinder the investigation and punishment in reality. Firstly, in order to avoid punishment, the affiliation behavior usually does not proceed openly. Instead, the subject of the behavior will rack their brains and use various hidden methods to cover up the affiliation. For example, using the name of internal contracting to carry out the affiliation, or using the name of subcontracting to carry out the affiliation, etc. However, it is not easy to distinguish between affiliation, subcontracting, and internal contracting themselves, which increases the difficulty of administrative investigation and punishment. Secondly, given the current objective situation of insufficient manpower in administrative departments, it is difficult to effectively improve the detection and investigation of affiliation. Thirdly, there is a lot of resistance to investigation and punishment. If administrative law enforcement is too strict, once it leads to mass incidents such as collective visits by migrant workers, it is easy to cause social instability factors, which to some extent leads to low enthusiasm of administrative departments in investigation and punishment. Based on the above reasons, administrative investigation and punishment are difficult and the effective investigation and punishment rate is low.

### **3.3. Low Cost of Illegal Acts**

According to relevant regulations, the construction contract is invalid, but if the project is qualified after acceptance, the contractor may request to pay the project price according to the contract agreement. Therefore, regardless of whether there is a qualification or affiliation, the actual builder can legally obtain the project price after completing the construction project, and their interests are not damaged at all. Moreover, if the actual builder claims to pay less or no management fees on the grounds of invalid contract, the situation of invalid contract may be more beneficial to the borrower, which is equivalent to encouraging affiliation. At the same time, except for the settlement of project price, which can be liquidated with reference to the stipulate about the project price in the contract, there is no provision in the current legal system that "other aspects can also be referred to", which means that other terms should generally be considered invalid. This may lead to the failure of the default liability for quality and duration that the employer could have claimed, and it is more difficult to ensure the quality and duration of the project.

## **4. SOLUTION**

### **4.1. Pre-Guarantee**

At present, the main ways to discover the affiliation are the investigation by government functional departments, as well as the examination and identification by the court after the parties have filed a lawsuit. However, no matter what the way is, it is difficult to discover the affiliation, which is due to the factors of the behavior subject hiding to avoid punishment, as well as the current regulatory model. In the current legal system, there are only post-punishment models such as fines and confiscation of illegal income. In comparison, changing the post-punishment model to the pre-regulation model is more effective. This paper proposes to change the existing methods of confiscating illegal income

and fines to a pre-guarantee method. Specifically, it can be stipulated that the lender and the borrower must pay a certain amount of retention money to the relevant government functional departments during the approval stage before the project starts. The subject and the amount of the money, the government functional departments that have the right to collect the money should be clearly stipulated to avoid confusion in practice caused by unclear regulations.

In addition, it is necessary to apply strict investigation and punishment systems to ensure the implementation of the pre-guarantee system. It should be noted that the investigation and punishment here are not aimed at the act of lending qualifications, but at the failure to pay the retention money at the failure of the lender to manage quality after lending qualifications, and other illegal behaviors. Regarding punishment measures, in addition to confiscating a larger amount of money than the retention money, it is also necessary to address the pain points of the lender, such as reducing or canceling the qualification level, in order to curb the occurrence of such behaviors.

## **4.2. Multi Party Cooperation**

In the past, the court was allowed to confiscate illegal income, which objectively made the court play the role of industry regulator. However, the regulation of affiliation is more about public law system considerations, while administrative punishment is one of the functions of administrative organs. Therefore, administrative organs and judicial organs should complement and cooperate with each other, clarify the boundaries between administrative functions and judicial functions, and build a linkage mechanism between judicial organs and administrative organs. The authority to confiscate illegal income and some other functions should be stripped from judicial organs and transferred to administrative organs.

After the revision of relevant documents, it is stipulated that the construction department shall accept and investigate the clues or evidence of engineering violations transferred by other agencies or departments according to law. And the Civil Code of the People's Republic of China has deleted the provision that "the court can confiscate illegal income", so it may be further stipulated that the court should transfer the clues or evidence of cases such as affiliation identified through review to government functional departments, so that administrative organs can be informed of relevant disputes timely and actively take administrative regulatory measures to deal with them. Specifically, the court can copy the judgment to the industry regulatory department, or invite these department to attend the court hearing, and the regulatory department can impose administrative penalties according to law for behaviors such as not paying retention money.

## **5. CONCLUSION**

China's construction market is still developing. Before the formation of a mechanism for rational allocation of resources and an orderly competitive construction market, affiliation will continue to exist. This stubborn problem in the construction industry may pose a huge hidden danger to engineering quality and safety, and expose all parties concerned to multiple risks such as civil disputes, administrative penalties, and even criminal liability. Employers should improve their risk awareness, strengthen their own qualification management from the perspective of static management, and do a good job in contract review and supervision. From the perspective of dynamic management, they should strictly enforce project performance inspection, fund management, and actual builder management systems, strengthen their attention to dynamic supervision and industry dynamics, and do a good job in prevention and control at the budding stage of risks. At the same time, contractors should also consider long-term development. They should not only have the ideal of becoming bigger and stronger, but also be responsible for the public, engineering quality and safety. Only under the supervision and guidance of the government, can the employer and contractor form a benign development of the construction market based on their own long-term considerations of development and social responsibility.

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