

## China's Latest Drive to Protect Automotive Consumers

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In line with the burgeoning ranks of the Chinese middle classes, China's automotive industry has been developing at a blistering pace in recent years, fed by the desire to own what remains a potent status symbol and, in some cases, a prerequisite for marriage in more prosperous parts of China. In light of the growing demand for passenger vehicles, there has been a review of legislative protection of consumer rights to introduce additional consumer protection rules similar to (and sometimes more extensive than) those found in more developed markets. The *Recall of Defective Automotive Products Administrative Provisions*<sup>1</sup> were issued back in 2004 but primarily regulate mandatory and voluntary mass recalls. There was previously no national regulation providing a basis for determining a car owner's rights in relation to repairs or returns of defective automobiles or automotive parts. Warranty terms were basically driven by automotive manufacturers' and sellers' contractual terms in a competitive market.

The Chinese government has now stepped in to require certain minimum standards in this area. The State Administration of Quality Supervision, Inspection and Quarantine ("AQSIQ")<sup>2</sup> issued the *Liability for the Repair, Replacement and Return of Household Automotive Products Provisions* on 29 December 2012, which took effect on 1 October 2013 ("**Auto Parts Provisions**"). The Auto Parts Provisions are the first national-level rules specifically governing the repair, replacement and return of automobiles and defective automotive parts (the "**Three Guarantees**")<sup>3</sup>. This note highlights some of the key provisions in the Auto Parts Provisions.

### SCOPE AND OBLIGATIONS

In terms of scope, the Auto Parts Provisions focus on the sellers<sup>4</sup> of passenger automotive products<sup>5</sup> produced or sold within China. However, manufacturers and repairers (together with the sellers, the "**Operators**") may also assume

the obligations based on agreements reached with sellers. Importantly, Article 3 of the Auto Parts Provisions states that the provisions therein form a baseline for Operators' commitments and that Operators are encouraged to provide more favourable terms to the consumer as part of the Three Guarantees.

### THE THREE GUARANTEES

Under the Auto Parts Provisions, the Three Guarantees are limited to a certain warranty period and validity term. The warranty period for an automobile is the earlier of three years or the time it takes to cover 60,000 kilometres, whereas the validity term is the earlier of two years or the time it takes to cover 50,000 kilometres. The distinction between the warranty period and validity term is important in determining the type of remedy available to the consumer.

#### Repairs and Replacements during the Warranty Period

In general, during the warranty period, repairs arising out of quality issues must be provided free-of-charge. In relation to more specific parts of an automobile, replacement of the defective part can be required by the consumer where (1) the main part of the engine or transmission is found to have quality issues within the earlier of sixty days from purchase or the time period needed to cover 3,000 kilometres or (2) for certain consumable spare parts (brake parts etc.) the part is found to have quality issues during the quality assurance period which is stated in the warranty document provided to each consumer. During the warranty period, if it takes more than 5 days to complete the repairs, the consumer shall be provided with a spare automobile or reimbursed for his/her reasonable travel expenses.

#### Replacements and Returns during the Validity Term

The Auto Parts Provisions allow consumers the option of returning a defective product in addition to replacing the same where the conditions are met during the validity term. The circumstances here relate to defects of critical components (i.e. steering and braking parts) which affect the safety of the passengers.

Specifically, replacement or return is available where there is a: (1) failure in the steering system, braking system, cracking on the bodywork of the automobile or fuel leakage, which occurs within the earlier of 60 days of purchase or the time needed to cover 3,000 kilometres, (2) a serious safety performance failure is not eliminated or results in a new safety performance failure after two repairs within the validity term, (3) the engine and/or transmission continues to work abnormally after it or the main parts have been replaced twice, and (4) the main part of the steering system, the braking system, the suspension system, the front or rear axle,

<sup>1</sup> In Chinese : 缺陷汽车产品召回管理规定. This regulation was issued jointly by AQSIQ, the National Reform Development and Reform Commission, the Ministry of Commerce and the General Administration of Customs.

<sup>2</sup> AQSIQ is a ministerial administrative organ directly under the State Council of the People's Republic of China generally responsible for setting standards for quality and commodity inspection.

<sup>3</sup> The Auto Parts Provisions refer to the repair, replacement and return (in Chinese : 修理, 更换和退货) of parts as the three guarantees (in Chinese : 三包). The same system of three guarantees applies to other consumer products, such as mobile telephones.

<sup>4</sup> "Sellers" are defined as any entity or individual which/who directly sells or delivers the product to the consumer, collects payment and issues sale official tax receipts. This will, therefore, include automotive dealers and agents.

<sup>5</sup> "Passenger automotive products" are defined as passenger cars purchased and used by a consumer for personal consumption.

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or the bodywork of the automobile continues to operate abnormally after two replacements for the same problem.

In addition, during the validity term, replacement of the automobile is mandatory upon request by the consumer where the product has undergone repairs for 35 days cumulatively or has been repaired for more than five times in aggregate for the same product quality problem. This provision is clearly targeting poor quality and "rogue" cars that constantly break down. The circumstances allowing a consumer to elect between a replacement or return of the defective automobile is not clearly set out in the Auto Parts Provisions and it remains to be seen how these will be distinguished in practice.

### **Timing**

In terms of timing, where a written request is made to the seller for the replacement or return of a product, the seller has ten (10) business days to reply to the request. Where the conditions for the replacement or return of a defective part of the automobile are met, the seller has 15 business days from the date on which the consumer demands the replacement or return of product or automobile to issue a certificate verifying the replacement or return. Refunds for returns are required to be made in a single lump sum. Where there is a replacement or return of the product, the Auto Parts Provisions do take into account compensation to be paid by the consumer to the seller for reasonable prior usage by the consumer.

### **EXEMPTIONS**

There are some exemptions from the provisions under the Auto Parts Provisions. Operators are exempt from the Three Guarantees under the following circumstances: (1) absence of a valid official tax receipt and a three-guarantee voucher from the consumer; (2) the consumer was previously informed in writing of existing defects; (3) the automobile is leased to others or used for other for-profit activities; (4) damage resulting from refitting, adjustment or disassembly by the consumer that is explicitly prohibited in the user manual; (5) damage resulting from improper handling by the consumer after occurrence of a product quality problem; (6) damage resulting from the consumer's failure to correctly use, maintain or repair the automobile in accordance with the user manual; and (7) damage as a result of force majeure.

### **OTHER REQUIREMENTS**

The Auto Parts Provisions also impose certain basic requirements for each of the Operators. These are not onerous on the Operators. For example, manufacturers must file and update basic information with AQSIQ including the automobile model produced, sales and repair outlets, and details of any claims and settlements made in relation to the Three Guarantees. Each automobile must now be accompanied by a Three Guarantee warranty document, which will specify the details of the automobile, the customer service contact and repair shop information, and the terms and conditions for any warranty claim. Sellers are required to explain and deliver the Three Guarantee warranty document to the consumer. Repairers must maintain and archive records and maintain reasonable reserves of automotive

spare parts with the relevant inspection certificates (fake parts remain an issue in China).

### **PENALTIES**

The Auto Products Provisions include penalty provisions for violations by Operators which include warnings, orders to rectify within a prescribed time limit and fines of between RMB10,000 and RMB30,000. Any such violations may also be made public, which may be more of a concern than the rather modest aforementioned penalties.

### **CONCLUSION**

The Auto Parts Provisions will certainly benefit consumers and will affect a wide swathe of the auto trade in China: not just the direct sellers of automobiles, but also manufacturers of automotive parts given that the sellers will undoubtedly seek to pass on or spread the risk. For those players who have previously left Chinese consumers high and dry with poor quality products that repeatedly break down, it may be a wake-up call. For those players who take their obligations to the Chinese consumer seriously, it will be seen in a more positive light as bringing a degree of consistency and clarity to the market, although it does raise serious business and profitability issues in terms of compliance if there is substantial consumer take up.

It will mean that all players in the industry in China will need to retool their Chinese operations to comply with the new rules, and it will be interesting to watch how the rules play out in practice. The Auto Parts Provisions are relatively short given their importance, and many of their principles and processes are not spelt out in detail. For example, the process for deciding if a product is defective is not clear and may end up being costly for the consumers. Given that the devil will be in the details, it will be interesting to see how the automotive brands treat the Auto Parts Provisions. The Auto Parts Provisions have been in the making for around a decade, and its recent release illustrates the Chinese government's belief that the quality of manufacturing has developed and advanced sufficiently in order for manufacturers to now be able to guarantee the quality of their products as envisaged in the Auto Parts Provisions. However, one possibility is that the Auto Parts Provisions will weed out some of the weaker players and will have a more serious financial impact on those whose products are unreliable or prone to break-downs. At the end of the day, auto makers and other stakeholders would be well advised to monitor the situation closely to ensure compliance with the Auto Parts Provisions as it is implemented throughout the market. Its coming into effect is widely reported in the media and the spotlight will be on how the provisions are put into practice going forward.

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## **FURTHER INFORMATION**

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