



# CPI Antitrust Chronicle

February 2015 (1)

## The Development of Antitrust Law in the Chinese Automobile Industry: An Evolving Regime

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## I. INTRODUCTION

There was a significant overhaul of the automobile industry in China in 2014. In mid-September 2014, several foreign automobile manufacturers, as well as their authorized dealers, were fined by the local pricing authorities, the provincial counterparts of the National Development and Reform Commission (“NDRC”), for violations of China’s Anti-Monopoly Law (“AML”). Around the same time, some new rules and policies were published or being contemplated by the other government authorities, including the State Administration for Industry and Commerce (“SAIC”), the Ministry of Transportation (“MOT”), and the Ministry of Commerce (“MOFCOM”).

In fact, China’s antitrust authorities started to pay more attention to the automobile industry back in 2012, if not earlier, when the China Automobile Dealers Association carried out a review of industry commercial policies, spare parts supplies, and after-sales services upon the instruction of NDRC, one of the three antitrust authorities in China in charge of enforcement against price-related monopoly conduct.<sup>2</sup>

This article explains the current distribution model in China’s automobile industry and how it originated. It then provides a summary of the recent legislation and policies in the industry that are aimed at solving potential antitrust issues. We also discuss areas of uncertainty within the Chinese legal framework and draw comparisons with EU practices.

## II. CHARACTERISTICS OF THE CHINESE AUTOMOBILE DISTRIBUTION INDUSTRY

In China, automobile distribution is mainly governed by the *Implementation Measures on the Administration of Automobile Brand Sales* (“*Measures*”), which were jointly promulgated in April 2005 by MOFCOM, NDRC, and SAIC. The *Measures* facilitated the establishment of a two-tiered distribution network with (i) a general distributor and (ii) authorized dealers, or the so-called 4S (sales, service, spare parts, and survey) stores that prevail in China’s automobile distribution industry.

According to the *Measures*, an automobile manufacturer shall appoint an exclusive general distributor, which, under the authorization of the manufacturer, will formulate and

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<sup>2</sup> See China is Investigating Automobile Pricing, a report by Reuters, available at <http://cn.reuters.com/article/chinaNews/idCNCNE97C09Y20130813>.

implement its distribution network planning.<sup>3</sup> The *Measures* further provide that an automobile manufacturer, or its general distributor, may only sell automobiles to authorized dealers, and these authorized dealers may only sell to consumers, unless otherwise approved by the manufacturer or its general distributor.<sup>4</sup> The authorized dealers are also required to engage in sales, services, and supply of spare parts of branded cars within their authorization and are prohibited from engaging in any business relating to non-authorized brand cars.<sup>5</sup>

Although the *Measures* do not prohibit dealers from obtaining authorization from multiple automobile manufacturers; in practice, because of commercial registration requirements,<sup>6</sup> each dealer is in fact bound to a single manufacturer.

The *Measures* were introduced at a time when under-developed sales and after-sales markets constrained the further development of China's automobile industry. According to an interview with the head of the Department of Market System Development of MOFCOM, prior to the effectiveness of the *Measures*, the authority did not attach as much importance to automobile distribution as it did to automobile manufacture.<sup>7</sup> However, in the *Policies on the Development of Automobile Industry*, which were published in 2004, it was required that "from 2005, automobile manufacturers shall realize brand sales and services for passenger cars" and that "automobile dealers shall operate their business within the scope as approved by administrations for industry and commerce." The *Measures* set out the details to implement these principles as approved by the State Council.

It is commonly recognized that, in its early stages, the *Measures* contributed significantly to improving the automobile distribution market, strengthening the quality of service of dealers and protecting the rights of consumers. With the development of the market, however, the *Measures* have been criticized for giving rise to an unbalanced position between the automobile manufacturers vis-à-vis the dealers and for being the breeding ground of alleged monopolies in both the sales and the after-sales markets.<sup>8</sup>

### III. RECENT LEGISLATION AND POLICIES

While NDRC launched a number of investigations into the automobile industry in 2014, other authorities intervened or expressed their concerns through the publication of a series of legislation and policies. Under the latest legal and policy framework, it appears that diversified forms of distributors will be encouraged to enter the market without the mandatory requirement for brand authorization. Exclusive supply of genuine spare parts is also being challenged, while the supply of comparable spare parts by third parties is being encouraged. Territorial restrictions

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<sup>3</sup> See the *Measures*, Article 3, 6 and 8.

<sup>4</sup> See the *Measures*, Article 18 and 28.

<sup>5</sup> See the *Measures*, Articles 25 and 27.

<sup>6</sup> According to the practice in commercial registration, dealers are exclusively registered with a single brand. See Chapter III Part A for more detail.

<sup>7</sup> See MOFCOM Expert Interpretation on *Measures on Automobile Brand Sales*, available at [http://news.xinhuanet.com/auto/2005-04/01/content\\_2771453.htm](http://news.xinhuanet.com/auto/2005-04/01/content_2771453.htm).

<sup>8</sup> See *Implementation Measures on the Administration of Automobile Brand Sales Create Controversy*, a report by CNR.CN, available at [http://www.cnr.cn/fortune/news/200503/t20050323\\_504044214.html](http://www.cnr.cn/fortune/news/200503/t20050323_504044214.html).

or channel restrictions might also become problematic. The automobile distribution and after-sales markets are facing tremendous challenges.

### **A. SAIC Proclamation to Cease Registration Requirements for Automobile General Distributors and Automobile Authorized Brand Dealers**

In August 2014, SAIC, the authority in charge of commercial registration, published a proclamation announcing that, from October 1, 2014, it would cease to register automobile general distributors and automobile authorized brand dealers. In addition, it announced that the scope of business of all dealers would be automobile sales, without limitation to a specific brand.

Previously, the automobile manufacturer or its general distributor were required to file certain dealer-related documents, including the brand authorization agreement, with SAIC<sup>9</sup> before the dealers could apply for business registration at the local Administration for Industry and Commerce (“AIC”).<sup>10</sup> The business scope as indicated on the dealer's business license would be “brand automobile sales.” Once registered at a local AIC, a dealer could not engage in the sales of other brands of automobiles, as this would be outside its business scope, which would be a violation of the *Company Law*.

However, after the revocation of the registration requirement, in theory a dealer can directly register at its local AIC without pre-authorization from automobile manufacturers and may develop business for multiple brands without going outside its business scope. Since the registration requirement to a certain extent ensures the implementation of the authorized distribution system required by the *Measures*, some industry experts consider that the abolition of this registration requirement indicates the *Measures* will undergo a significant change.<sup>11</sup>

### **B. SAIC Guiding Opinion on Enhancement of Automobile Market Supervision**

Two months after the proclamation was published, SAIC issued the *Guiding Opinion Regarding the Supervision on Automobile Market* (“SAIC Guiding Opinion”), as an effort to implement the *Several Opinions on Promoting Fair Market Competition and Safeguarding Normal Market Order* issued by the State Council.

The *SAIC Guiding Opinion* emphasizes the protection of the legitimate interests of “various market players” in the automobile market and free choice for consumers. It also reaffirms the revocation of the registration system for automobile general distributors and authorized brand dealers, so as to “encourage diversified business models and market players.” It sends a clear signal to the industry that the current model of authorized distribution system is being challenged.

Moreover, the *SAIC Guiding Opinion* also emphasizes that the authority will focus on customer complaints and media exposure, with enhanced supervision and enforcement against monopoly agreements and abusive conduct in the automobile industry. SAIC also vows to

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<sup>9</sup> See the *Measures*, Article 9 and 10.

<sup>10</sup> See the *Measures*, Article 13, which provides that “when applying for registration, dealers shall bring the certificate of Provider’s filing with SAIC to the local Administration for Industry and Commerce.”

<sup>11</sup> *Expert Interpretation of the Proclamation re End of Brand Registration*, a report by CNAUTONEWS.COM, available at [http://www.cnautonews.com/jrtt/201408/t20140812\\_320410.htm](http://www.cnautonews.com/jrtt/201408/t20140812_320410.htm).

formulate and promote the use of standard automobile sales and maintenance agreements to delineate the rights and obligations of business operators and consumers.

SAIC is responsible for enforcement in respect of non-price-related monopoly conduct under the AML. Like the legal framework of most other jurisdictions, the conduct rules under the AML also regulate monopoly agreements and abuse of a dominant market position. However, unlike most other jurisdictions, where the antitrust enforcement authority is vested in a single agency, the enforcement authority of Chinese conduct rules is split between NDRC and SAIC, depending on whether the conduct is price-related or non-price-related. In fact, price-related monopoly agreements are a major target of the AML, as stipulated in Article 13(1)(1), which prohibits horizontal price-fixing agreements, and Article 14, which prohibits vertical resale price-maintenance agreements. The recent antitrust decisions against automobile manufacturers and their dealers were based on those provisions.

On the other hand, the AML does not expressly prohibit non-price-related vertical monopoly agreements. Article 14(3) of the AML provides a catch-all clause granting antitrust agencies the authority to find other non-price-related vertical agreements to be monopolistic. However, in practice, this clause has not yet been applied in publicized decisions.

Although the *SAIC Guiding Opinion* is quite high-level and general, it at least suggests that SAIC is paying particular attention to anticompetitive conduct in the automobile industry. It is expected that SAIC may publish more detailed guidelines on what constitutes a non-price-related vertical monopoly agreement. If the EU framework is followed, it would not be surprising if more vertical restrictions, such as territorial, customer, or channel restrictions, were regulated in the future. This would directly influence the way market players do business in the automobile industry.

### **C. MOT Guiding Opinion on Improvement of Automobile Repair and Maintenance Industry**

In September 2014, after soliciting public opinions,<sup>12</sup> the MOT and nine other ministries jointly issued the *Guiding Opinion on Improvement of Automobile Repair and Maintenance Industry* (“*MOT Guiding Opinion*”), aimed at upgrading the after-sales service sector and improving service qualities. The *MOT Guiding Opinion* was drafted on the basis of MOT’s survey of the automobile maintenance industry.<sup>13</sup> Notably, it encourages broadening spare parts supply channels. It also targets the abuse of warranty clauses and requires the mandatory release of technical information for repair and maintenance, so that independent maintenance enterprises are able to compete more effectively with authorized ones.

#### **1. Broadening Supply Channels of Spare Parts**

“Genuine spare parts” generally refers to spare parts manufactured by automobile manufacturers or their OEMs. Currently in China, exclusive supply and exclusive purchase

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<sup>12</sup> The draft version of the MOT Guiding Opinion was published by MOT for comment on June 24, 2014. See the Draft Version of the MOT Guiding Opinion and the Notice for Soliciting Opinions, available at [http://www.moc.gov.cn/zfxxgk/bnssj/dlyss/201406/t20140630\\_1642674.html](http://www.moc.gov.cn/zfxxgk/bnssj/dlyss/201406/t20140630_1642674.html).

<sup>13</sup> Liu Xiaoming, Head of Traffic Division of the Ministry of Transport, commented in an interview, available at [http://www.moc.gov.cn/zhuzhan/ft2014/qichewxyshjzhx/wenzishilu/index\\_3458.html](http://www.moc.gov.cn/zhuzhan/ft2014/qichewxyshjzhx/wenzishilu/index_3458.html).

requirements are not uncommon in the after-sales market. In an exclusive supply arrangement, a spare parts supplier will sell exclusively to an automobile manufacturer. The latter will then resell those spare parts exclusively to authorized maintenance enterprises. Authorized maintenance enterprises are normally prohibited from reselling the spare parts to other maintenance enterprises, making them the only source for genuine spare parts in the after-sales market.

To promote the fair competition in the repair and maintenance market and protect freedom of choice by customers, the *MOT Guiding Opinion* (i) encourages genuine spare parts producers to sell genuine spare parts and spare parts with their own trademarks directly in the after-sales market, (ii) allows authorized maintenance enterprises to resell genuine spare parts to unauthorized maintenance enterprises or consumers, and (iii) states that all maintenance enterprises and consumers should have the same access to high quality spare parts.

In fact, exclusive dealing is not a *per se* violation of Article 13 or Article 14 of the AML. As mentioned above, it is not a type of vertical monopoly agreement explicitly prohibited by the AML. However, if a company has a dominant market position, exclusive dealing without justification could constitute an abuse of dominance, in violation of Article 17(4) of the AML. In China's automobile sales market, it may be difficult to establish that any major automobile manufacturer holds a dominant position, as competition is fierce and none of the automobile manufacturers holds a significant market share.<sup>14</sup>

In the after-sales market, however, a number of foreign cases have suggested that the relevant market should be narrowly defined as the brand-specific market.<sup>15</sup> The European Commission considers that the markets for repair and maintenance services and for the distribution of spare parts are generally brand-specific in nature and that, insofar as a market exists for after-sales services that is separate from the sale of new motor vehicles, that market is considered to be brand specific.<sup>16</sup> It appears that the approach to exclusive supply requirements in the *MOT Guiding Opinion* is generally in line with the EU antitrust law principles.<sup>17</sup> The *MOT*

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<sup>14</sup> See, *Top 20 of Automobile Seller in China 2013: Self-Owned Brand Accounts for 1/3*, a report by Gasgoo, available at <http://auto.gasgoo.com/News/2014/02/14013015301560282419768ALL.shtml>.

<sup>15</sup> For example, in *Eastman Kodak Co. v. Image Tech. Servs.*, 504 U.S. 451, 481-482 (U.S. 1992), the Court stated "The relevant market for antitrust purposes is determined by the choices available to Kodak equipment owners. Because service and parts for Kodak equipment are not interchangeable with other manufacturers' service and parts, the relevant market from the Kodak equipment owner's perspective is composed of only those companies that service Kodak machines."

<sup>16</sup> See the European Commission's Supplementary Guidelines on Vertical Restraints in Agreements for the Sale and Repair of Motor Vehicles and for the Distribution of Spare Parts for Motor Vehicles, 2010/C 138/05, ¶¶15 and 57.

<sup>17</sup> For example, Article 5 of the European Commission's Motor Vehicle Block Exemption Regulation (No 461/2010) prohibits restrictions on the sales of spare parts for motor vehicles by members of a selective distribution system to independent retailers which use those parts for the repair and maintenance of a motor vehicle; restrictions on the ability of a supplier of spare parts to sell those goods to authorized or independent distributors, authorized or independent repairers or end users; and restrictions on a supplier of component parts used for the initial assembly of motor vehicles to place its trade mark or logo effectively and in an easily visible manner on the components supplied or on spare parts. Further, Article 4(d) of the Vertical Block Exemption Regulation (No 330/2010) prohibits restrictions on the ability of a supplier of components to sell those components as spare parts to end-users or to repairers or other service providers not entrusted by the buyer with the repair or servicing of its goods.

*Guiding Opinion* provides clearer guidance than the AML in relation to the business models in the automobile industry.

It is of note that the *MOT Guiding Opinion* does not address exclusive purchase requirements imposed on authorized dealers by automobile manufacturers or their general distributors. This appears to suggest that the *MOT Guiding Opinion* is more tolerant of exclusive purchase requirements than exclusive supply requirements.

## 2. Preventing the Misuse of Warranty Clauses

The *MOT Guiding Opinion* stipulates that automobile manufacturers should not limit or intervene with consumers' independent choice of maintenance enterprises, or refuse to provide warranty services on the basis that the automobile has been maintained by a non-authorized maintenance enterprise within its warranty period.

According to the *MOT Guiding Opinion*, consumers should be given the right to choose any maintenance enterprise, whether authorized or not, for maintenance services.

According to the *Regulation on Maintenance, Replacement, and Return of Household Automobile* ("*Three Warranties Regulation*"), automobile manufacturers and maintenance enterprises may refuse to provide warranty cover in respect of damage caused by (a) consumers' wrongful conduct, or (b) consumers' failure to maintain or repair in accordance with the manual. It is foreseeable that, with the proliferation of non-authorized maintenance entities, disputes will arise between the automobile manufacturers and maintenance enterprises on the one hand, and consumers on the other, as to what exactly is the cause of a damaged car and who should bear the responsibility for such damage. To address such disputes, authoritative independent institutions are required. As mentioned in the *MOT Guiding Opinion*, third-party dispute mediation institutions should be established and improved with "available channels, efficient services, authoritative techniques, and justified decisions."

The *MOT Guiding Opinion* only prohibits refusals to provide warranty cover during the "three warranties" period. It does not address extended warranties which consumers may purchase after the initial warranty period has expired. Therefore, it appears that automobile manufacturers or general distributors are permitted to impose restrictions in extended warranties that prevent consumers from using non-authorized maintenance enterprises.

Similarly, in the European Union, a vehicle manufacturer can include restrictions relating to servicing or spare parts in an extended warranty that is bought by a consumer from an authorized repairer or from the vehicle supplier some years after the purchase of the vehicle.<sup>18</sup> Such restrictions may include making the warranty conditional on the end user having repair and maintenance work that is not covered by the warranty carried out within the vehicle manufacturer's authorized repair networks. The warranty conditions may also require the use of the vehicle manufacturer's brand of spare parts in respect of replacements not covered by the warranty terms.

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<sup>18</sup> See FAQs 1-5 of the European Commission's Frequently Asked Questions on the application of EU Antitrust Rules in the Motor Vehicle Sector, 27 August 2012.

The rationale behind the EU practice is that, years after a vehicle is purchased, authorized dealers do not enjoy the same degree of privileged access to consumers as they do in the period shortly after the purchase. As a consequence, alternative providers of extended warranties are unlikely to face significant barriers preventing them from offering their products to vehicle owners. In such circumstances, the European Commission considers it unlikely that independent repairers could face a significant foreclosure effect even if warranties issued by providers contain servicing restrictions.

### 3. Publishing Automobile Maintenance Technology Information

The *MOT Guiding Opinion* stipulates that, from January 1, 2015, automobile manufacturers (including enterprises that import and sell automobiles in China) must publish automobile maintenance technology information in respect of new automobiles that enter the Chinese market. For existing models, the deadline to publish such information is December 31, 2015. The information must be published without discrimination and delay to both authorized and independent maintenance enterprises, in available information forms, convenient for access, and for reasonable fees. A failure to comply with these requirements will result in the removal of the relevant model from the Announcement of Automobile Manufacturers and China Compulsory Certification (“CCC”), meaning that the relevant automobile manufacturer would be unable to sell that model in China.

According to a MOT official, there is a monopoly over access to maintenance technology information in the market.<sup>19</sup> Given access to technical information, as well as genuine spare parts, independent enterprises will be more competent to provide a satisfactory service.

There are currently no detailed rules about publishing information, other than the principles set out in the *MOT Guiding Opinion*. It is unclear what the scope is of information to be published and whether there will be any exceptions to the requirements. Further explanation and guidance is needed to understand how this requirement will operate in practice.

In the European Union, qualitative selective distribution agreements concluded with authorized repairers and/or parts distributors may be caught by competition law if one of the parties acts in a way that forecloses independent operators from the market; for instance, by failing to release technical repair and maintenance information to them.<sup>20</sup> Further, where a supplier is the only source of all the technical information needed to perform repair and maintenance work on motor vehicles of its brands, agreements with its authorized repairers and/or parts distributors may be caught by the prohibition against restrictive agreements if the supplier fails to provide independent operators with appropriate access to its brand-specific technical repair and maintenance information.<sup>21</sup> Exceptionally, a failure to provide such information may be justified for safety or security reasons. However, this is unlikely where the

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<sup>19</sup> Liu Xiaoming, Head of Traffic Division of the Ministry of Transport, commented in an interview, *available at* [http://www.moc.gov.cn/zhuzhan/ft2014/qichewxyshjzhx/wenzishilu/index\\_3458.html](http://www.moc.gov.cn/zhuzhan/ft2014/qichewxyshjzhx/wenzishilu/index_3458.html).

<sup>20</sup> See ¶62 of the European Commission’s supplementary guidelines on vertical restraints in agreements for the sale and repair of motor vehicles and for the distribution of spare parts for motor vehicles.

<sup>21</sup> See ¶63 of the European Commission’s supplementary guidelines on vertical restraints in agreements for the sale and repair of motor vehicles and for the distribution of spare parts for motor vehicles.



supplier is likely to be the only source for the full range of technical information relating to vehicles of its brands.<sup>22</sup>

The *MOT Guiding Opinion* has taken a step beyond the AML in regulating the automobile spare parts and maintenance market. However, except for disqualifications for failure to release technical repair and maintenance information, the *MOT Guiding Opinion* does not contain any penalty provisions. It remains to be seen how the opinion will be enforced in practice.

#### ***D. MOFCOM Draft Measures on Automobile Sales***

Since the second half of 2014, MOFCOM has circulated several rounds of the Draft Measures on Automobile Sales (“*Draft Measures*”), which will ultimately replace the existing *Measures*, for consultation among various government departments and industry associations.<sup>23</sup> MOFCOM is one of the three antitrust enforcement agencies in China in charge of merger control. However, the Department of Market System Development is taking the lead in drafting the *Draft Measures*, rather than the Anti-Monopoly Bureau of MOFCOM.

The most distinctive feature of the latest version of the *Draft Measures* is that the measures play down the concept of “authorized dealers” and encourage other types of sales models, including automobile supermarkets, automobile trade centers, and online automobile markets to compete with the current 4S stores.<sup>24</sup> This change is in line with the *SAIC Opinion* and the *MOT Guiding Opinion*. However, in the near future, authorized distribution systems will probably continue to be the principal model of automobile distribution in China, given that authorized dealers have more experience in sales of automobiles and the provision of after-sales services to consumers.

Moreover, the *Draft Measures* include a number of provisions that are particularly aimed at prohibiting monopoly conduct. Some provisions in the *Draft Measures* echo what is stipulated in the AML, such as prohibiting resale price maintenance,<sup>25</sup> whereas other provisions are not expressly featured in the AML, such as prohibition of territorial restrictions and channel restrictions. From this point of view, the *Draft Measures* go further than the AML and take a more proactive approach in regulating the automobile industry.

Despite the relatively comprehensive rules, the *Draft Measures* are vague on certain issues. For territorial restrictions, the *Draft Measures* only stipulate that the automobile manufacturer or its general distributor may not limit sales to customers according to their domicile.<sup>26</sup> Strictly construed, this provision only forbids restrictions on passive sales, where consumers visit dealers on their own initiatives. For active sales, where dealers establish a show

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<sup>22</sup> See FAQs 15 of the European Commission’s Frequently Asked Questions on the application of EU Antitrust Rules in the Motor Vehicle Sector, 27 August 2012.

<sup>23</sup> See Change 4S Model, Countdown to the Revision of the Implementation Measures on the Administration of Automobile Brand Sales, a report by EEO.com.cn, available at <http://www.eeo.com.cn/2014/1017/267438.shtml>.

<sup>24</sup> *Id.*

<sup>25</sup> See, New Measures on Automobile Sales in the Pipeline, a report by Zhongshan Business Newspaper Auto Weekly, available at <http://auto.zsnews.cn/archive.php?aid=560986>.

<sup>26</sup> *Id.*

room or take other promotional activities in a region other than the one it is contractually responsible for, the automobile manufacturer or its general distributor may arguably impose a restriction without violating the *Draft Measures*.

This approach is also adopted by the European Commission. For example, the *Vertical Block Exemption Regulation* permits restrictions of active sales (but not passive sales) into an exclusive territory reserved to another supplier, provided the relevant agreement meets the requirements stipulated in the Regulation.<sup>27</sup>

As for channel restrictions, the *Draft Measures* stipulate that the automobile manufacturer or its general distributor may not prohibit cross-selling among “dealers selling their automobiles.”<sup>28</sup> In contrast, the *Measures* as currently in force implicitly prohibit cross-selling, as dealers are only allowed to sell to consumers.<sup>29</sup> The *Draft Measures* seem to be consistent with the EU competition rules on this issue, as the *Vertical Block Exemption Regulation* prohibits restrictions on cross-supplies between distributors within a selective distribution system.<sup>30</sup>

There is a little uncertainty though as to whether this provision could be interpreted more broadly to even allow an authorized dealer to sell automobiles to independent dealers, in which case it would be even more aggressive than the EU rules. This would arguably undermine the authorized distribution system, which recognizes that high-tech products, such as automobiles, should be sold by properly trained staff who understand the product and are able to provide appropriate after-sales services.

The *Draft Measures* also cover an issue which is left open in the *MOT Guiding Opinion*; namely, the exclusive purchase requirements. The *Draft Measures* would require automobile manufacturers and their general distributors to ensure consumers are given a free choice for “general” spare parts,<sup>31</sup> and prohibit the imposition of exclusive purchase requirements on dealers for the sale of “general” spare parts. When the *Draft Measures* are formalized, the challenge for an automobile manufacturer or its general distributor will be to distinguish the so-called “general” spare parts from the others, unless it abandons the exclusive purchase requirements for spare parts entirely. The *Draft Measures* would not leave much leeway for an automobile manufacturer or its general distributor on this issue.

In contrast, under the EU rules, an automobile manufacturer or its general distributor may be permitted to impose non-compete obligations on a dealer; for example, obliging the

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<sup>27</sup> Article 4(b) of Commission Regulation No 330/2010 on the Application of Article 101(3) of the Treaty on the Functioning of the European Union to Categories of Vertical Agreements and Concerted Practices, 20 April 2010 (“Vertical Block Exemption Regulation”). See also, ¶51 of the European Commission’s Guidelines on Vertical Restraints.

<sup>28</sup> See *supra* note 25

<sup>29</sup> See the *Measures*, Article 28.

<sup>30</sup> See Article 4(d) of the Vertical Block Exemption Regulation.

<sup>31</sup> See *supra* note 25.

dealer to purchase more than 80 percent of their total purchases of general spare parts from the automobile manufacturer or its general distributor.<sup>32</sup>

As mentioned above, the *Draft Measures* cover some provisions already included in the AML, but also provide rules in respect of conduct that is not explicitly banned in the AML. It is reasonable to expect that once the *Draft Measures* are formally introduced, automobile manufacturers may need to carry out an extensive review of their daily operations to ensure compliance.

### ***E. Development of Parallel Imports***

The Chinese government is also encouraging parallel imports to try to introduce more competition in the automobile industry. In the automobile industry, parallel imports generally refer to imports through legitimate channels without authorization from general distributors. According to the existing *Measures*, foreign automobile manufacturers are required to authorize or establish domestic enterprises to be their general distributor for sales of imported automobiles in China. Nevertheless, parallel imports have long existed in the Chinese automobile market. According to the *Regulations on Imports and Exports* and *Regulations on Mandatory Product Certification*, any enterprises that are granted an automobile imports license by MOFCOM may legitimately import automobiles through customs, so long as such automobiles have passed the relevant quality inspections. In other words, parallel imported automobiles are allowed, but only those imported from independent channels.

It was hoped that, when the Shanghai Free Trade Zone was established in 2013, the legal status of parallel imports would be clarified. In November 2014, the General Office of the State Council issued the *Opinion on Improvement of Imports*.<sup>33</sup> The *Opinion* calls for modification to regulations on automobile brand sales and also suggests introducing a pilot project for parallel imports to be formally conducted in the Shanghai Free Trade Zone. In January 2015, the Shanghai Municipal Commission of Commerce, together with four other administrations, issued the *Notice on the Launch of Pilot Project for Parallel Imports in Shanghai Free Trade Zone*.<sup>34</sup> The notice sets certain thresholds and procedural requirements for applicants. It is understood that the Shanghai Waigaoqiao (Group) Co. Ltd. plans to establish a trade center in the Shanghai Free Trade Zone, providing both sales and after-sales services.

In practice, parallel imported automobiles may enjoy a significant price advantage, although they do face certain barriers. First, most parallel imported automobiles must meet

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<sup>32</sup> The Vertical Block Exemption Regulation permits a motor vehicle supplier and a distributor to agree on a non-compete obligation, causing the buyer not to manufacture, purchase, sell or resell goods or services which compete with the contract goods or services, or imposing an obligation on the dealer to purchase from the suppliers or from another undertaking designated by the supplier more than 80 percent of the buyer's total purchases of the contract goods or services and their substitutes on the relevant market. This is provided that the market share test in the Regulation is satisfied, the agreement is not between actual or potential suppliers in the same product market, and the agreement does not contain any hardcore restrictions identified in Article 4 of the Regulation. Non-compete obligations will only be exempt if they comply with the conditions set out in Article 5 of the Regulation.

<sup>33</sup> Available at [http://www.gov.cn/xinwen/2014-11/06/content\\_2775819.htm](http://www.gov.cn/xinwen/2014-11/06/content_2775819.htm)

<sup>34</sup> Available at <http://www.scofcom.gov.cn/service/search/content.jsp?contentid=MjM3NDcx>

certain Chinese standards. In order to register an imported automobile, the importer must make necessary modifications to fully comply with these standards.

Second, before entering the China market, imported automobiles must hold CCC certification, which involves a considerable application fee and the provision of four automobiles for each model to carry out safety tests. More importantly, as required by the *Regulation on Compulsory Product Certification*, parallel importers must submit relevant agreements with automobile manufacturers before applying for the CCC certification.<sup>35</sup>

Third, according to the *Three Warranties Regulation*, sellers are primarily responsible for warranties. However, most parallel importers are not capable of providing proper maintenance services. Alternatively, importers can purchase commercial insurance on behalf of their consumers. Even though the expense is covered, consumers may still have difficulties with after-sales maintenance, because the spare parts and technical information for maintenance and repair of foreign-standard-automobiles may be different from those for Chinese-standard-automobiles.

Given these challenges, the development of parallel imports in the automobile industry is proving to be a slow and difficult process.

#### IV. CONCLUSION

The AML has been in effect for more than six years and has started to reshape the business models of almost all industries in China, to differing degrees. The automobile industry in particular has become a key focus for not only the antitrust authorities, but also the competent authorities responsible for the automobile industry in China. It is expected that there will be an overhaul of the current prevailing business models in the industry. However, as the legal framework is still being developed, uncertainties remain, which create challenges for automobile manufacturers and their dealers. It may be advisable to start to consider whether mechanisms and agreements in place need to be adapted in order to keep up with the fast-evolving legal environment in China.

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<sup>35</sup> See the procedure for CCC application, available at [http://www.cnca.gov.cn/ywzl/rz/qzxcpl/zdjs/200609/t20060925\\_1610.shtml](http://www.cnca.gov.cn/ywzl/rz/qzxcpl/zdjs/200609/t20060925_1610.shtml).