# New Rules on Sale of Automobile Brands

—— David Yu

On 21 February 2005, the Ministry of Commerce ("MOC"), the National Development and Reform Commission ("NDRC") and the State Administration for Industry and Commerce ("SAIC") jointly promulgated the *Administration of Automobile Brand Sales Implementing Procedures* (the "Procedures"). Aiming to improve China's automobile sales system and service quality, the Procedures stipulate that general distributors and brand dealers must obtain authorization from the suppliers in order to sell automobiles of the suppliers' brands in China[1]. In addition, the Procedures also establish the thresholds and procedures for entry of general distributors and brand dealers into the automobile market, and specify the respective obligations of automobile market players, i.e. suppliers, general distributors and brand dealers.

**Background**

Considering the fast-growing automobile market and the corresponding regulatory reform, the promulgation of the Procedures could be deemed as a significant step taken by the authority for the implementation of the *Automobile Industry Development Policies* (the "New Policy") issued by the State Council back in June 2004. The New Policy stipulates that "beginning year 2005, automobile manufacturers shall engage in brand sales and services of their self-produced passenger automobiles, and from 2006 onwards, brand sales and services of all other self-produced automobiles shall be implemented". According to the New Policy, automobile manufacturers, both foreign and domestic, are required to establish brand sales and service system for upgrading China's automobile market. It is obvious that the intention of the authority is to provide consumers with services of standardized quality under a systematic brand management, a characteristic of a highly-regulated market. MOC published the draft Procedures for public comment on 23 September 2004. It was reported that more than 12 government departments were involved in the discussions and drafting of the Procedures. The regulation was finalized in February and became effective as of 1 April 2005, three months behind the scheduled date.

**Stipulations of the Procedures**

According to the Procedures, "automobile brand sale" refers to all automobile-related business activities conducted by automobile suppliers and brand dealers by using unified trade name, logo, trademark etc. MOC and its counterpart at provincial levels are responsible for the administration of automobile brand sale, and SAIC as well as its counterpart at provincial level are responsible for the supervision of automobile brand sale. The Procedures further define that "suppliers" means the enterprises providing automobile resources to brand dealers, including manufacturers and general distributors; "brand dealers" means the enterprises authorized by suppliers to sell automobiles and to provide relevant services by way of brand sales; and "general distributors" means the enterprises authorized by manufacturers (both foreign and domestic) to establish automobile brand sales and service system and to carry out automobile distribution domestically.

In order to sell self-produced automobiles in China, the suppliers shall establish an integrated brand sales and service system to improve marketing and service quality. Further, each supplier shall work out its own brand sales and service network plan, which includes operation forecast, sales store planning proposal, network implementation schedule and the standards for construction, software, hardware and after-sale services. Generally, according to the Procedures, the planning and implementation of the network plan for the same brand shall be undertaken by the same supplier. In the case of domestic registered suppliers, they are allowed to plan and implement the network plan themselves or engage a general distributor to do so. Overseas registered suppliers have to engage a registered Chinese general distributor to work out and implement the network plan.

**Set Up Requirements and Application Procedures**

The Procedures set out certain requirements for setting up general distributors and brand dealers. General distributors shall fulfil the following conditions for establishment:

(1) possess the status of enterprise legal person;
(2) obtain the written authorization from manufacturers to independently carry out distribution of automobiles of certain brands; and
(3) possess expertise in automobile marketing.

Brand dealers shall fulfil the following conditions for establishment:

(1) possess the status of enterprise legal person;
(2) obtain the written authorization from suppliers to sell automobiles of certain brands;
(3) use the same trade names, logos and trademarks as authorized by suppliers;
(4) have the places, equipments and experts tailored to the scope and scale of the business;
(5) conform to the relevant development standards of the local municipality.

General distributors shall submit the relevant documents for establishment to SAIC for filing[2]., and suppliers shall submit the relevant documents of the brand dealers to SAIC for filing[3]. The business scope of general distributors and brand dealers shall be "branded automobile sale"[4]. In case of change of brands, the establishment procedures mentioned above shall be complied with.

**Issues concerning Foreign Investors**

Prior to the promulgation of the Procedures, MOC issued the *Administration of Foreign Investment in Commercial Sector Procedures* on April 6, 2004, regulating foreign investment in the commercial sector. Although this piece of regulation covers foreign-invested automobile sales companies, a lot of gaps in regard to regulation of such companies are left to be filled in by future regulations.

As for foreign investors that wish to invest in general distributors or brand dealers, the Procedures actually set a higher threshold for foreign investors. For the establishment of foreign-invested general distributors or brand dealers, establishment applications shall first be submitted to the MOC's provincial-level counterparts for preliminary examination. Applications shall then be forwarded to MOC for approval. It should be noted that the power to grant approval is internally shared between MOC and SAIC. Furthermore, prior to 11December 2006, the investment proportion of a single foreign investor of a general distributor or brand dealer shall not exceed 49% of the share capital of the general distributor or brand dealer if the general distributor or brand dealer opens more than 30 shops in total[5].

**Rights and Obligations of Market Players**

Based on the discretion of whether to grant authorizations to brand dealers, suppliers will hold a more positive, or even dominant position when dealing with brand dealers, which offers suppliers the necessary conditions to plan, establish and maintain their own brands sales and service systems. However, suppliers must take the corresponding responsibilities: to provide automobile and brand resources to authorized brand dealers; to offer warranties concerning product quality and services to consumers; to lay out and program sale and service network; and to provide training and support to authorized brand dealers on marketing, service and technology. On the other hand, suppliers are prohibited to sell automobiles directly to consumers within the areas in which brand dealers are authorized by the suppliers to carry out sales activities unless otherwise stipulated in the license agreements[6].

An unauthorized distributor will face a difficult situation in that if they fail to obtain authorization from suppliers, they will be "flushed out" from the market. It should be noted that the Procedures allow a transition period for a distributor to obtain the necessary authorization from the supplier by 1 October 2005 instead of 1April 2005, the date on which the Procedures take effect. Brand dealers may also be concerned with the multi-brand operation issue. As a matter of fact, the Procedures do not expressly prohibit multi-brand operation. In theory, brand dealers can obtain several authorizations from automobile manufacturers of different brands. However, the Procedures actually increase the cost for brand dealers to obtain such authorizations. There is also a high possibility that suppliers add exclusivity clauses into the license agreements to prevent brand dealers from obtaining authorization from other suppliers.

**Conclusion**

Although the Procedures have a major impact on the relevant players in the automobile market, the provisions in the Procedures are not water-tight. For example, the Procedures do not provide for the consequences of breach of the Procedures, hence making the Procedures more like a policy than a law.

This may pose obstacles to the implementation of the Procedures. Therefore, more specific rules for implementation are necessary

The Procedures grant the suppliers autonomy in establishing their own sales and service system to be complied with by all the general distributors and brand dealers. The issues then are how to prevent suppliers from making rigor and unfair provisions in the license agreements and how to protect the interests of brand dealers. The Procedures do, however, restrict some of the rights of the suppliers. For instance, the Procedures stipulate that the suppliers must reach an agreement with brand dealers, and the agreement must be fair and non-discriminatory. The Procedures also provide that suppliers may not sell automobiles to customers in the territory where a brand dealer is authorized to sell the automobiles; and that suppliers may neither interfere with the construction, facility allocation, business activities of a brand dealer except for what is stipulated in the authorized operation agreement, nor impose minimum sales volume or force the brand dealer to co-sell other products. However, despite such provisions in the Procedures, it is believed that brand dealers and suppliers are in different market positions and have unbalanced bargaining power.

In addition, the Procedures are silent on certain important issues. For instance, how should the word "brand" be defined? Shall "Shanghai Volkswagen" and "FAW Volkswagen" be regarded as one brand or two? Can a brand dealer sell automobiles of multiple brands? The unofficial answer will be that since the suppliers are responsible for and in control of their own products according to the Procedures, they shall therefore have the final say on these issues.

A more fundamental issue will be that, although the Procedures intend to change the existing automobile market to a large extent, the automobile market as it currently stands is far from being ready to accept the changes exerted by the Procedures. As a result, the Procedures may offend many interests and induce certain market players to resist, elude or distort the Procedures. This in turn, leads to the question of whether the Procedures can be effectively implemented. Will the Procedures promote the development of China's automobile market? The answer can only be provided by future legislation and the reaction of the automobile market to the Procedures.

Endnotes:

1. Articles 8 and 9 of the Procedures.
2. Article 10 of the Procedures.
3. Article 36 of the Procedures.
4. Article 13 of the Procedures.
5. Article 16 of the Procedures.
6. Article 22 of the Procedures.

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