

International Luxury Brands May Face Product Quality Enforcement In China

Article By:

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China celebrated its Customer Right Protection Day on March 15, 2010. The Administration for Industry and Commerce of Zhejiang province (the “**Zhejiang AIC**”) issued penalty decisions to several well-known international luxury brands such as Hermes, Hugo Boss, Dolce & Gabbana, Paul & Shark, Trussardi, Tommy Hilfiger and Versace based upon routine quality examinations which found goods sold in China to be substandard.

According to findings by the Zhejiang AIC, the geographical places of manufacture of the substandard luxury goods are located in eleven countries and regions, including Italy, Turkey and France. The major problems with the imported luxury goods were quality and safety issues and counterfeit materials. The Zhejiang AIC detailed such problems as: (i) disqualified color adhesion; (ii) failure of PH value testing; (iii) excessive content of formaldehyde; and (iv) misdescribed fiber content. The Zhejiang AIC has seized the substandard luxury goods and filed cases against entities who sold such luxury goods.

With its continuing growth as a major contributor to the global economy, China has been recognized by international luxury brands as an emerging multi-billion dollar consumer market with a legal system that is less advanced as other nations regarding consumer protection. Since joining in the WTO, Chinese authorities have observed the significant market for international luxury brands and the huge numbers of local consumers who are actual and potential market consumers. In recent years, more and more consumer complaints have been voiced regarding product quality. Chinese central and local government authorities have given attention to strengthening consumer protection and enforcement against substandard products produced by foreign luxury brands.

Consumer protection laws in the People's Republic of China are based upon two major laws: Chinese Product Liability Law (the “**PLL**”) and Law of Protection of Consumer Rights and Interests (the “**LPCRI**”). The PLL requires that all goods must be safe to consumers and their property, and adhere to State Standards or trade criteria enacted to ensure the health and safety of people and their property. The LPCRI gives customers the following rights: (i) inviolability of their personal and property safety; (ii) accurate and true information regarding the goods they have purchased and the services they have paid for and received; (iii) free choice of goods or services; and (iv) fairness in

consumer transactions. Although, currently, no large-scale recalls of foreign luxury goods have occurred in China, consumers who have suffered from personal injury or property damage resulting from their purchase or use of goods or services have the right to demand compensation pursuant to the LPCRI. Under the PLL, the retailers of foreign luxury goods may also be fined.

The respective Administrations of Industry and Commerce (“**AIC**”), at both central and local level, are the key consumer protection enforcement authorities. The State Administration of Quality Supervision, Inspection and Quarantine (“**SAQSIQ**”) plays the important role of inspecting and making determinations regarding product defects. In product defect cases regarding luxury brands, consumers usually report problematic products to local Consumer Protection Associations, which are civil consumer protection organizations. Consumer Protection Associations have no administrative or judicial enforcement authority but act as an intermediary for consumers to report typical cases or widespread complaints about brands to the AIC or SAQSIQ. Such reports may trigger local or even national AIC or SAQSIQ investigations concerning such products.

Where Luxury Brands Have Goods Produced in China:

Major raw materials of textile and baggage products are locally sourced. Most products manufactured in China and other Asian nations are produced under OEM arrangement by local manufacturers (especially in southern and eastern areas). Quality control enforcement systems may be based upon the luxury brand's licensing requirements but in some instances local quality control may be difficult to enforce in China at a consistent level of high quality comparable to the licensor's own factories and headquarters.

Under such circumstances, maintaining effective quality control and enforcing such requirements locally with the Asian manufacturer and material suppliers are essential in order to ensure the consistent high quality of branded products. The contractual arrangements with the local sources and manufacturers and the maintenance of control of tools, molds, usage of machines, qualification of workers, quality inspection, enforcement of internal quality rules, and compliance with compulsory product quality specifications and standards are all critical to production and manufacturing by luxury brands in China. In certain cases, local manufacturers may take on additional work and increase the manufacturing output of a factory without advising or receiving approval of the contracting party. In addition, in some cases, manufacturers fail to destroy or return to the licensor all rejected or substandard goods and instead sell such rejected goods to the local “underground market”, which may then give the public access to such rejected goods. These rejected and unauthorized luxury goods in the Chinese marketplace have caused trouble for luxury brands in China.

In terms of the brand reputation, some critics have said that many luxury brands do not have sufficient consumer support or after-sale services in China. Even though China has no applicable recall policy, Chinese consumers view luxury branded goods in China as being of the same high quality as the luxury brand. Luxury brands which establish a network of supportive post-sale support and policing of unauthorized and pirated goods, as well as procedures for return or recall where goods are substandard, will help protect their brand equity as well as avoid difficulties with Consumer Protection Associations and AIC or SAQSIQ investigations.

With respect to consumer sales, the LPCRI and PLL, and even the contract law of China, courts are very protective of consumers and will interpret standard contracts or unilateral contracts that favor the sellers only against the drafter. As the LPCRI and PLL both seek to protect consumers, luxury brands should carefully review their sales and post-sale consumer policies in China to ensure that such policies are “fair” to consumers and afford basic consumer rights to ensure that consumer complaints

or legal actions are avoided.

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