

The following presentation was made by CMSI President, Tom Lynott to MIC officials in March of 2009 and also to the top 40 Chinese Motorcycle and Scooter manufacturers at the 2008 Canton Trade Fair.

What is a “Gray Market” Vehicle?

•“Gray market” vehicle is a term the government and general public uses to describe any vehicle that is sold in the marketplace that does not meet all the legal requirements to be a safe and legally owned and sold vehicle. •Many European automobiles in the 1970s were imported into the U.S. as “Gray Market” products until the U.S. Government cracked down on the importers and distributors. Fiat and Yugo brands fell into this group.

••The biggest culprits making and selling “Gray Market” vehicles today are the Chinese scooter, motorcycle and ATV manufacturers.

••The fraud that is being committed on the U.S. consumer, small businessmen and government agencies is causing a public safety and pollution hazard.

••The key elements to the fraud and causes of the “Gray Market” problem are outlined in the following slides.

Main Reasons for “Gray Market” scooters and motorcycles -EPA Violations

•EPA non-compliance is due to the fact that many Chinese manufacturers obtain an EPA Certificate of Conformity in the name of a “U.S. paper company” that is set up in the U.S. without any operations or staff or parts or service.

•The Chinese U.S. owned subsidiary exists in name only. It serves the purpose of holding the EPA Certificate so that the Chinese company can sell its vehicles to anyone who can pay for them and import them into the U.S. using the Chinese paper company as the registered importer, even though the paper company is not actually involved in the purchase, shipping or warehousing and sales of the imported vehicles.

•Even though the EPA requires the Certificate holder to provide parts under warranty to fulfill the EPA’s stipulated emission components replacement requirements, the Chinese paper company cannot meet the EPA warranty commitments as it has no parts and no operations in the U.S.

•Many of the importers who bring vehicles into the U.S. under the paper company’s EPA Certificate, sell via the Internet and have no parts or warranty programs for the vehicles they sell.

Main Reasons for “Gray Market” scooters and motorcycles -CARB Violations

•CARB non-compliance is usually due to the fact that most Chinese vehicle makers do not understand the extra measures that CARB requires such as evaporative emission systems that require different fuel tanks and vapor containment vessels and hose routing schemes.

•Most testing of Chinese vehicles to gather data used for the application for EPA and CARB certification is done on specially prepared test vehicles that will pass the testing regime. 90% of the emission testing is done in the U.S. at EPA approved test labs.

•Most Chinese manufacturers, who have not agreed to rigorous outside inspections such as CMSI employs, do NOT follow the exact specifications of the test vehicles, on their production vehicles. This is a violation of EPA and CARB rules. It is usually done to save costs or because the emission components are not easily sourced inside China from friendly vendors with easy payment terms.

•Most Chinese vehicle assemblers do not manufacture many of the components on their vehicles and are essentially “assembly houses”. If one of their vendors changes an emission component to save money or because they can no longer source a part, the assembler accepts this (especially if the cost is reduced) and does not notify EPA of a “Running Change” or do any re-testing as is required by EPA and CARB.

Main Reasons for “Gray Market” scooters and motorcycles -DOT, NHTSA Violations

•DOT non-compliance is rampant among Chinese vehicle makers. They do not want to incur the extra cost of compliance testing and obtaining of English language Test Reports in correct NHTSA format.•However, Chinese vehicle makers mis-label the Certification Labels and other labels to indicate that the vehicle is compliant with DOT. In many cases the embossing of DOT on certain parts is all that has been done and no lab testing of components or systems has occurred.

•At the 2008 Canton Trade Fair, Tom Lynott presented a notice and a sign-up sheet to 40 of the largest vehicle manufacturers in China. These companies represent 90% of the vehicle exports from China to the U.S. All of these companies stated that they would be willing to conduct testing and bring their vehicles into DOT compliance if the DOT regulations were enforced and all of them had to comply!

•Chinese companies do not file EWR and other reports as required by NHTSA. CFR 49, part 579 “Reporting of Information and Communications About Potential Defects.”

Sub Parts A, B, and C)

Main Reasons for “Gray Market” scooters and motorcycles -DOT continued.

- The primary reason that non-compliance with DOT safety regulations is allowed to flourish is that unlike EPA, **DOT and NHTSA compliance is self administered by the vehicle manufacturer.**
- The manufacturer states that the vehicle is compliant with all FMVSS in affect on the date of manufacturer and places a Certification Plate on the vehicle. DOT and/or NHTSA do not issue any certificates.
- DOT did not have much of a problem with non-compliance of DOT’s FMVSSs prior to vehicles being imported into the U.S. from China.
- The prior importation of vehicles subject to street legal regulations was done by major corporations with **assets at risk** in the U.S. or at least who had customers and distributors who had assets at risk in the U.S. and were afraid of violating the DOT rules and being subject to large fines for any found violations.
- However most Chinese vehicle makers (assemblers) have no assets at risk in the U.S. and sell mostly to unsophisticated buyers who are not aware of the rules and in most cases are trying to make a fast buck and do not have reputations or significant assets at risk themselves. The Chinese companies are not establishing a “brand name” and see their products as commodities. They blatantly violate U.S. laws.

Main Reasons for “Gray Market” ATVs & Off-road motorcycles -CPSC (Consumer Product Safety Commission)

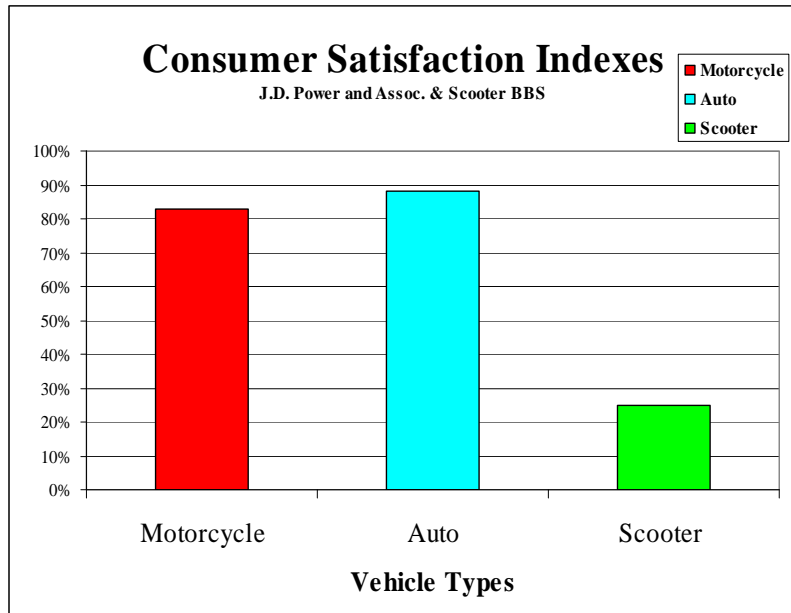
- The CPSC (Consumer Product Safety Commission) regulates the U.S. off-road vehicles for safety. DOT regulates the on-highway vehicles under its FMVSS regulations.
- The primary vehicles that CPSC regulates are ATVs and UTVs.
- 99% of the youth ATVs that are imported into the U.S. do not meet CPSC regulations. (See Feb. 11th “Ban” on last slide)
- CMSI tried unsuccessfully in 2005 and 2006 to introduce youth ATVs into its dealer network.
- The primary reason that CMSI’s ATVs were not accepted by dealers and consumers was due to the fact that they were designed to conform to all of the CPSC rules. As a result they were much slower and quieter and more costly to produce and sell than the non-compliant ATVs being sold by competitors.
- The Federal agencies are now enforcing these rules more rigorously.
- If the Federal government does not enforce the relevant rules, States can step in under their own jurisdiction, and enforce the rules.

Non-Compliance with DOT Gray Market Penalties!

- The new Obama administration has committed to much **stronger enforcement of consumer protection laws**. This action is especially attractive for the government when it also means that new jobs will be added for Americans who have lost their jobs to “off-shore” workers and who will be hired by AIM.
- Under existing rules listed in CFR 49 book, penalties for violations are severe and are imposed on the **original manufacturer**, in spite of their being a foreign company.
- Referring to the CFR 49, section 578.6 and 579.3 the **foreign manufacturer is responsible for compliance with the various rules and regulations and includes reporting of safety defects and any complaints or claims filed against that manufacturer in any country that the manufacturer has sold vehicles.**
- The penalties for violations are listed below:
 - Motor Vehicle Safety Standards:**(FMVSS). \$6,000 per vehicle and **\$16,375,000** max. for a related series of violations.
 - Title Information:** \$1,100 per case
 - Consumer Information:** \$1,100 per case, \$500,000 maximum
 - Country of Origin:** \$1,100 per case
 - Odometer tampering:** \$2,200 per case
 - Vehicle theft device tampering:** \$1,100 per case
- Failure to report under part 579 “**Reporting of Information and Communications About Potential Defects.**”
 - SubPart A: General
 - SubPart B: Reporting of Safety Recalls and Other Safety Campaigns in Foreign Countries.
 - SubPart C: Reporting of Early Warning Information

Why Chinese Vehicle manufacturers now face big problems in the U.S.

- Lack of Quality Control & Testing. Unsafe vehicles.
- Non-Compliance with DOT, EPA, CARB and CPSC.
- Black Market “drop shipping” via Internet.
- Consumers/Small Businesses being “ripped off”
- Many Chinese vehicle makers sell to anyone and enable uneducated U.S. importers to set up distribution of private label brands without adequate infrastructure of customer service and/or dealer after-sale support.
- Non-compliant vehicles pollute the environment and endanger public safety.
- No Service or parts infrastructure, no product liability insurance. Massive consumer dissatisfaction after receipt of “drop shipped” scooter (see chart)
- Hundreds of thousands of “orphaned” vehicles (scooters, motorcycles and ATVs)



CMSI knows and follows the rules!



CMSI President Tom Lynott with Greg James, a leading TNG Regional Center Owner and Operator based in Rusk, Texas

What Tom Lynott has done in the past and recently to clean up markets and create self-regulatory groups...Boating Certification Program – BIA

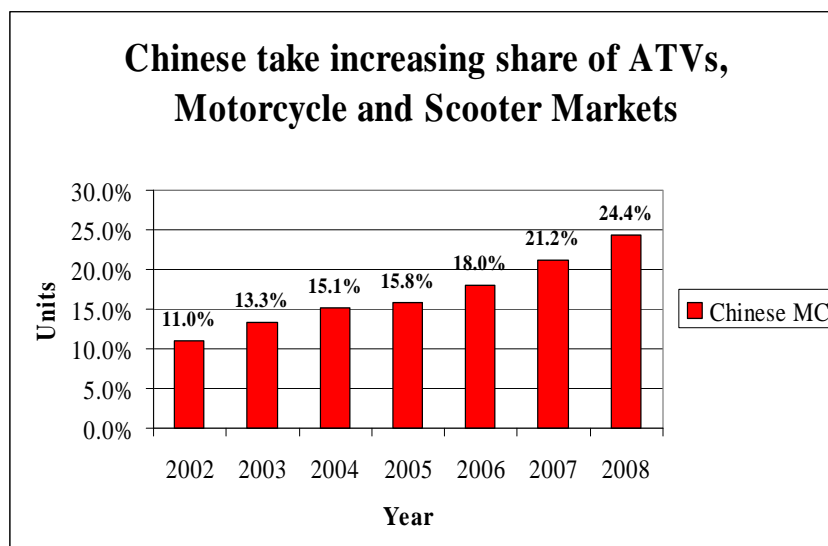
- As President of Reinell Boat Co. in the 1960s, Lynott became active in the industry's fledgling trade association, BIA. The boating market was growing rapidly and accidents were increasing and business was worried about government legislation that would regulate manufacturers under proposed U.S. Coast Guard rules.
- The Boating Industry Association, BIA, with Lynott's focused involvement, was able to head off heavy-handed regulation and created a **Certification Program** that became the standard for self-regulation for the boating industry manufacturers.
- BIA Certification** became the "de facto" requirement for any serious player in the industry and was regarded by the Coast Guard as sufficiently strong to ensure boaters' safety. "Stable and Upright" floatation, even when totally swamped, was a major factor in BIA certification standards.

What Lynott has done in the past and recently to clean up markets and create self-regulatory groups...Canadian Motorcycles and Scooters.

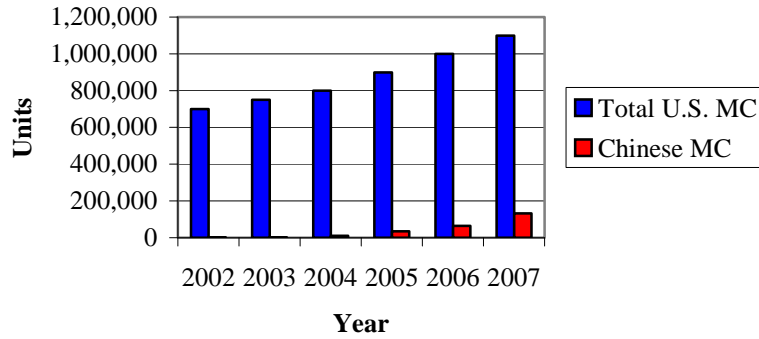
- In 2006, as President of CMSI, Lynott led a group of scooter and motorcycle importers to meet in Montreal with the Director of Transport Canada's division regulating scooters and motorcycles.
- As a result of this meeting and follow-on discussions, **Transport Canada** (equivalent to U.S. DOT) agreed that applications for importation of scooters and street legal categories of motorcycles would be routed to accredited industry trade associations for review and approval prior to their submission to TC for clearance through customs. **Actual lab test reports are required for all systems.**
- As a result of this self-regulatory process, a de-factor **Certification Program** has become the standard for self-regulation for the on-highway motorcycle and scooter industry manufacturers.
- This **Industry Certification Program** and process has resulted in the virtual elimination of "Gray Market" vehicles in the Canadian market. TNG scooters are among the few China sourced products in this market as most other Chinese sourced brands do not make it through this process.

How Severe is the U.S. "Gray Market" Safety Problem from non-compliant Chinese Vehicles?

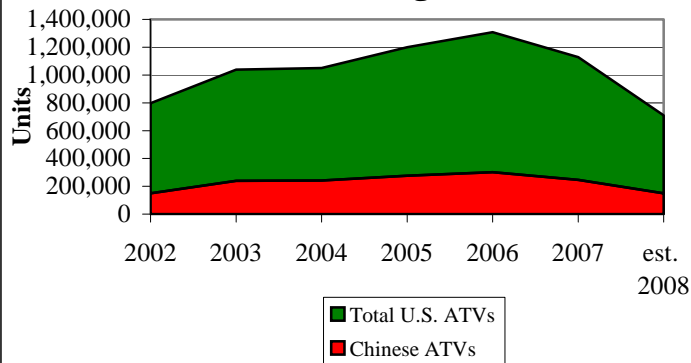
- According to an article in Powersports Business magazine in December of 2008, the U.S. Customs and Border Patrol recently released figures that showed **in 2007 there were 491,000 Chinese vehicles imported into the U.S.** This covers ATVs, scooters and motorcycles plus dune buggies. (It does not include golf carts and UTVs.)
- It is estimated knowledgeable industry professionals that almost one in three or 28% of all ATVs sold in 2007 made Chinese.
- Because most street legal motor scooter sales are not reported to the industry's association MIC, accurate information is difficult to obtain other than by person to person reports. However, it is believed that almost **60% of all motor scooters sold in 2007 were Chinese made.**
- Because the American motorcycle market is dominated by larger displacement machines like Harley Davidson and Honda, only 12% of the motorcycle market is believed to have been gained by Chinese made models, mostly in youth and entry level models.



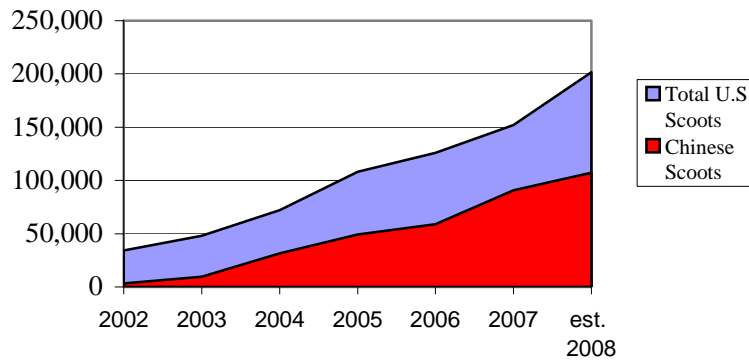
Chinese Took Increasing Share of Motorcycle Market...especially the small displacement models



Chinese Took Increasing Share of the Declining U.S. ATV Market



Chinese Scooters Dominate Market and over 50% of Chinese units are sold on-line or at "big box" stores! ...without warranty or parts support in violation of EPA certification!



What are DOT and EPA Doing?

- CMSI's CEO Tom Lynott and COO Bret Larsen have had numerous discussions with NHTSA's head Administrators regarding the huge public safety problem due to the large number of unsafe and non-compliant Chinese vehicles now on the U.S. public roads.
- The NHTSA is now working with state governments to begin tightening of rules for registration of any vehicles that have VIN numbers beginning with "L". Pennsylvania now requires that all VINs starting with "L" must go to the state capitol for review. This delays the registration process by several weeks and may cause some buyers to rescind their purchase.
- CMSI management has also had numerous discussions with EPA. EPA is now implementing a policy that will penalize any company that has an EPA Certificate in "name only" and does not actually have a U.S. operation to provide parts, technical and warranty claims processing for its U.S. customers, as required in the EPA certification application and letter of commitment from the manufacturer.

What is MIC Doing?

- MIC requires that its members comply with the various regulatory agencies rules and regulations but presently has no **Certification Program** in place. CMSI is now working with MIC to create an **MIC Certification Program**.
- MIC can be a leader in creating the same self regulatory **Certification Program** that has been successful in both the U.S. boating industry, with its BIA Certification Program and as in Canada with the Trade Association **Certification Process**.
- An effectively developed and administered and well promoted and sponsored **MIC Certification Program** can be a crucial factor in cleaning up the U.S. "Gray Market" problem without heavy handed and expensive government intervention and bureaucratic delay.

What is CPSC Doing?

- The Consumer Product Safety Commission has ruled that effective February 11, 2009 no youth ATVs or motorcycles can be sold in the U.S. market due to excess lead content. That includes inventory on hand at distributors and retail dealers.
- CPSIA: "Black Tuesday" for youth motorbikes**•by [Walter Olson](#) on February 11, 2009
We blogged earlier [about Honda's and Kawasaki's](#) having pulled out of the U.S. market and ordered a halt to sales of their youth motorbikes. A similar Jan. 26 letter from third big maker Yamaha is [reprinted here](#), and [smaller makers are rumored](#) to have taken the same step.
- Thiel's Wheels of Ohio**: "We cannot sell you replacement parts for the ones you already own. This is not our decision; it is being made for us."
[DealerNews \("The Voice of PowerSports Retailers"\)](#): "The value of inventories that now cannot be sold is unknown, **but it probably exceeds \$100 million, by our estimate**. Just take 7,500 franchised dealers, many of whom carry \$25,000 worth of inventory at wholesale cost."
- CPSC regulates all off-highway vehicles including ATVs, UTVs and dirt bikes.