



# Caveat emptor in China

A prosecution in the US highlights the risks of doing business in China, especially with shipyards, writes **Rajesh Joshi**

**> Warning to owners lured by cheap** Chinese newbuildings: your transaction may not proceed exactly as planned.

A court drama in New Jersey last week offered a bizarre example of just how wrong things can go. A warrant was issued on 27 August for the arrest of Chinese businessman Qiu Gengmin for contempt of court, stemming from a value added tax (VAT)-related civil suit brought by Norwegian owner IM Skaugen.

The saga began in 2005, when Skaugen ordered three LPG/chemical carriers at Taizhou Wuzhou Ship Industrial in China. The parties hired Qiu-owned Zhejiang Changda Import and Export as agent, tasked with handling the refund of VAT to Skaugen after the ships were ‘exported’ – that is, delivered.

The VAT refund and ship delivery went smoothly on the first Skaugen tanker, *Norgas Pan*. But Qiu allegedly absconded with the money he was supposed to refund on the second ship, *Norgas Cathinka*. The ensuing controversy left the third

newbuilding, *Norgas Camilla*, stranded for a year after completion.

Arbitration was held in Hong Kong against Qiu and Zhejiang Changda. In separate awards this year, the arbitrator ordered Qiu in his personal capacity to pay Skaugen about \$9.34M, plus interest.

Skaugen’s investigators alleged that Qiu fled to the United States in 2010 and a Chinese prosecutor issued an arrest warrant against him for contract fraud. Upon arriving in America, he allegedly purchased two houses in New Jersey and an apartment in New York’s Queens district with a total market value exceeding \$1M.

### Restraining order

On 24 April Skaugen brought an action before US district court judge Michael Shipp to enforce the arbitration. Shipp immediately issued a temporary restraining order, directing that ownership of the properties remain in situ while the case progressed.

In his defence, Qiu accused Skaugen of being a “greedy and unprincipled

multinational that is colluding with the Chinese communist security apparatus to use commercial disputes as disguises to cripple and eliminate political dissidents.” (Qiu claimed to be a political dissident.)

His defence further ridiculed the Hong Kong arbitration as “fraudulent” and a “ghost arbitration”, about whose progress and conclusion he was kept in the dark. Instead of sending correspondence to his Chinese address, from where it was returned, he should have been contacted in New Jersey, Qiu chided Skaugen.

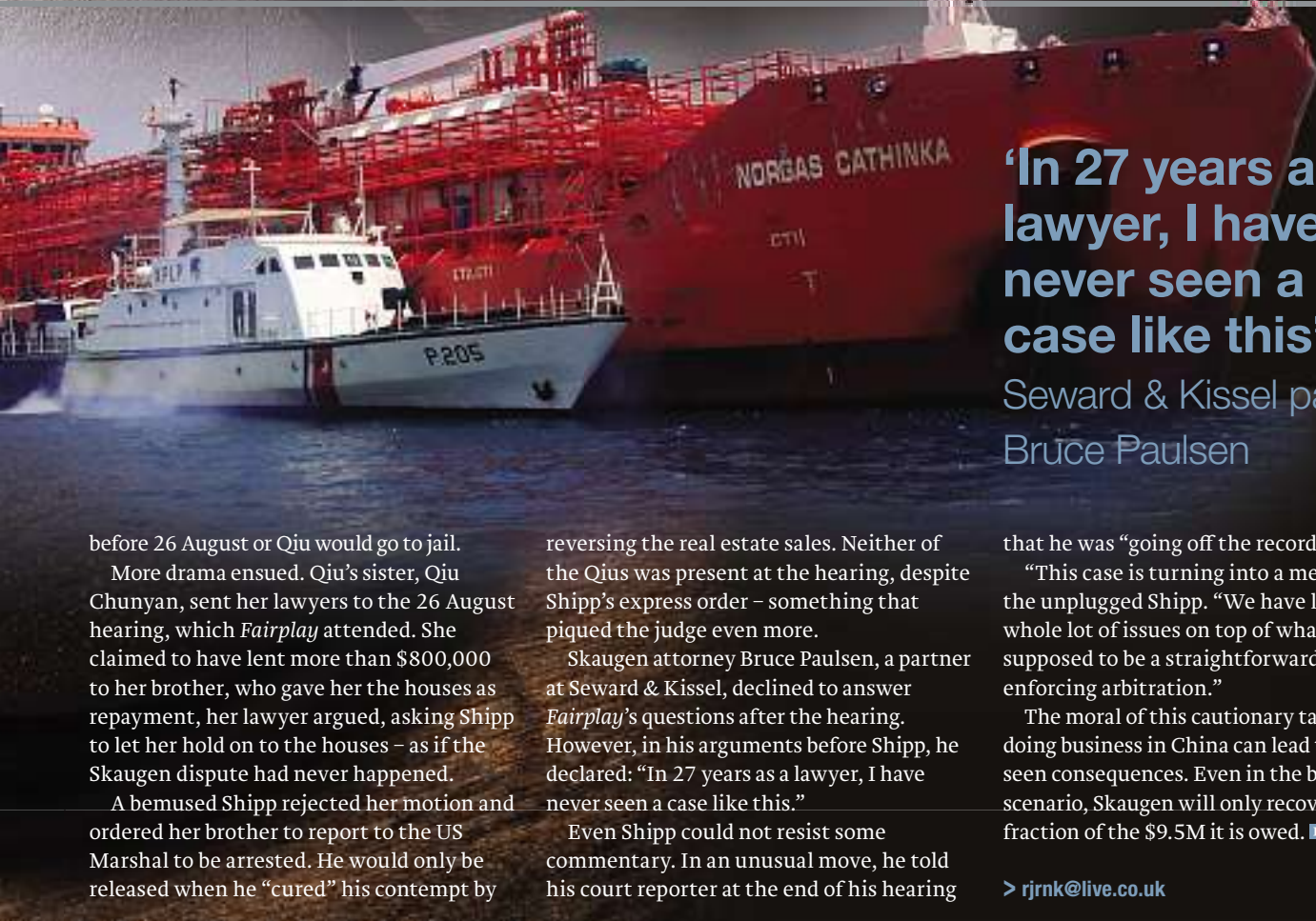
On 22 July, Shipp issued an order confirming the arbitrations and directing Qiu to pay Skaugen more than \$9.65M. By then, Skaugen had discovered that Qiu had allegedly “sold” the two New Jersey houses in April to suspected relatives, apparently for \$10 each, a day after Shipp’s temporary restraining order.

Another court complaint followed, and on 9 August Shipp held that Qiu was in contempt of court.

The judge ordered that the sales be reversed

Skaugen's *Norgas Cathinka*, at the centre of a court row in the US, pictured being escorted by Indonesian police after a collision with a passenger ferry in the Sunda Strait in September 2012

Shutterstock/Reuters/Lynda Hargreaves



## 'In 27 years as a lawyer, I have never seen a case like this'

Seward & Kissel partner  
Bruce Paulsen

before 26 August or Qiu would go to jail.

More drama ensued. Qiu's sister, Qiu Chunyan, sent her lawyers to the 26 August hearing, which *Fairplay* attended. She claimed to have lent more than \$800,000 to her brother, who gave her the houses as repayment, her lawyer argued, asking Shipp to let her hold on to the houses – as if the Skaugen dispute had never happened.

A bemused Shipp rejected her motion and ordered her brother to report to the US Marshal to be arrested. He would only be released when he “cured” his contempt by

reversing the real estate sales. Neither of the Qius was present at the hearing, despite Shipp's express order – something that piqued the judge even more.

Skaugen attorney Bruce Paulsen, a partner at Seward & Kissel, declined to answer *Fairplay*'s questions after the hearing. However, in his arguments before Shipp, he declared: “In 27 years as a lawyer, I have never seen a case like this.”

Even Shipp could not resist some commentary. In an unusual move, he told his court reporter at the end of his hearing

that he was “going off the record”.

“This case is turning into a mess,” said the unplugged Shipp. “We have layered a whole lot of issues on top of what was supposed to be a straightforward matter of enforcing arbitration.”

The moral of this cautionary tale is that doing business in China can lead to unforeseen consequences. Even in the best-case scenario, Skaugen will only recover a fraction of the \$9.5M it is owed. ■

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## > Hard lessons of the red book

Thanks in part to a “red book” that local agent Qiu Gengmin allegedly failed to submit to Chinese authorities, IM Skaugen (IMS) suffered substantial loss of income attributable to a delayed newbuilding.

IMS took delivery of the second ship in the Wuzhou series in October 2009. Qiu obtained the \$3.7M VAT refund on this ship soon after. According to IMS, the US-bound Qiu never sent this cash to Wuzhou for onward remittance to the owner.

Qiu, the court heard, also “intentionally did not assist with customs or other export formalities” on the second ship as required by contract. These formalities are understood to include the submission of a standard “red book” to the authorities.

Non-submission of this document, among other things, triggered a bureaucratic nightmare: delivery of the third and final ship was held up, as its contract was deemed “hindered”.

The Hong Kong arbitrator and US district judge

Michael Shipp sided with IMS on this matter. However, Qiu's New Jersey defence paints a different picture.

The September 2005 tripartite contracts between IMS, Wuzhou shipyard, and Qiu's company, Zhejiang Changda, were voided long before he came to the United States, he argued. Changda also changed its status to “self-support exporter” from “agent”, the capacity in which it was hired.

These changes washed Changda clean of any obligation towards IMS and, in any case, he was not responsible for Changda's corporate payables, Qiu argued.

How things got to this point is another tale. By IMS's own admission, Changda had to be roped in as intermediary solely because Wuzhou did not have state authorisation to “export” ships.

Qiu pounced on this aspect too. Wuzhou's sale of ships to a foreigner was essentially illegal, he told Shipp. IMS's transactions at

the yard, Qiu alleged, establish the owner's complicity in Changda's “complete destruction by the allied forces combining [sic] Chinese communist security apparatus”.

In a September 2005 media release, IMS highlighted its positive contribution to the growing Chinese LPG trade and China's drive “to build its petrochemical industry into a world-class operation”.

The release added: “IMS has experience building complicated gas ships at Chinese yards that have limited experience in such ships, especially for export customers. This co-operation creates more of a partnership to manage the risks and share the rewards.”

“IMS's aim is to assist this shipyard [Wuzhou] in developing its business to service the future export markets.”

The final takeaway for owners doing business in China: despite your good intentions, be prepared for the worst.