

RED GOLD: THE LEGAL FRAMEWORK GOVERNING FOREIGN INVESTMENTS IN CHINA'S OIL INDUSTRY

*Jackie Zhong**

I.	INTRODUCTION	654
II.	BACKGROUND	655
	<i>A. A Brief Look at China's Oil Industry</i>	655
	<i>B. A Brief Look at Foreign Investments in China</i>	658
III.	A CLOSER LOOK AT FOREIGN INVESTMENTS IN CHINESE OIL.....	661
	<i>A. Oil Ownership and Upstream Production</i>	663
	<i>B. Petroleum-Related Laws and Regulations</i>	665
	<i>C. Laws and Regulations Governing Foreign Investment</i>	670
	<i>D. Implementing the Mineral Resources Law</i>	672
	<i>E. When Investing in the Chinese Oil Market</i>	674
	<i>F. Dispute Resolution</i>	678
	<i>G. A Brief Discussion of Taxes and Fees</i>	681
	<i>H. Guarding Against Corruption</i>	684
IV.	CONCLUSION.....	686

*“So valuable is black gold to our very way of life that wars
have been waged for it...”*

-BLACK GOLD: THE STORY OF OIL IN OUR LIVES-

* Jackie Zhong is a 2016 Juris Doctor candidate at the University of Houston Law Center. She received a Bachelor of Arts in English/Creative Writing from Emory University. This comment received the 2015 Mr. and Mrs. James W. Skelton, Jr. Award for Outstanding Comment in International Energy Law.

I. INTRODUCTION

China's economic ascension began with Deng Xiaoping's rise to power in 1979.¹ At first, China remained self-sufficient in oil.² However, as the country's own oil supply became outstripped by its economic boom, China eventually became a net oil importer.³ By late 2013, China had become the world's biggest importer of oil, edging out the United States.⁴ Even though the United States uses approximately 7.7 million more barrels of oil per day than China, the United States is increasingly able to support its own oil demand due to domestic hydraulic fracturing, or "fracking."⁵ Such an approach is more difficult in China due to complicated geology and high production costs.⁶ Because of this, the Chinese government has begun to realize that it cannot develop an efficient oil sector without bringing in foreign investment and new technology.⁷

Deputy Director of the National Energy Administration (NEA), Liu Qi, said at the First Energy International Investment Cooperation Forum held in Beijing in 2012 that China encourages foreign investors to carry out petroleum exploration and development in the country.⁸ For a prospective foreign investor, successfully investing in China's oil market would require due diligence and consummate knowledge of its laws and regulations regarding petroleum and foreign investment.

1. HAIJIANG HENRY WANG, *CHINA'S OIL INDUSTRY & MARKET* vii, 2-3 (1999).

2. *Id.* at vii, 165.

3. *Id.* at vii, 229; *see also* *China Overtakes US as the Biggest Importer of Oil*, BBC NEWS (Oct. 10, 2013), <http://www.bbc.com/news/business-24475934> (describing how China's economic growth has created a demand for imported oil).

4. *China Overtakes US as the Biggest Importer of Oil*, *supra* note 3.

5. *Id.*

6. Mike Orcutt, *China's Shale Gas Bust*, MIT TECH. REV. (Aug. 12, 2014), <http://www.technologyreview.com/news/529996/chinas-shale-gas-bust/>.

7. WANG, *supra* note 1, at vii.

8. *China Encourages Foreign Investors to Explore Unconventional Oil and Gas*, CHINA BRIEFING (Dec. 12, 2012), <http://www.china-briefing.com/news/2012/12/12/china-encourages-foreign-investors-to-explore-unconventional-oil-and-gas.html>.

II. BACKGROUND

A. *A Brief Look at China's Oil Industry*

When China began reforming its economy in the late 1970s, the country focused on advanced technology as the pathway to economic success.⁹ Deng Xiaoping said, “It is becoming increasingly clear that science and technology are of tremendous significance as productive forces.”¹⁰ With this in mind, China sent scientists and engineers to other countries to study advanced technologies.¹¹ China also began to stress organizational innovation in reforming large firms in strategic sectors such as oil.¹²

During the course of two decades, government ministries slowly evolved into large state-owned enterprises.¹³ In the late 1990s, China began restructuring and reforming these enterprises.¹⁴ This included major state-owned oil companies such as PetroChina, Sinopec, and the China National Offshore Oil Corporation (CNOOC).¹⁵ The structure of these modern corporations was established with the help of international consultants and investment bankers.¹⁶

The oil industry is a pillar of the Chinese economy,¹⁷ and the country's state-owned oil companies play a large role.¹⁸ China National Petroleum Corporation (CNPC) is China's largest oil and gas producer and supplier.¹⁹ CNPC is also the sponsor and

9. JIN ZHANG, *CATCH-UP AND COMPETITIVENESS IN CHINA 1* (2004).

10. *Deng Xiaoping's Revisionism (2): Science and Technology as Part of the Productive Forces*, LESMATERIALISTES.COM (July 8, 2013), <http://lesmaterialistes.com/english/deng-xiaoping-s-revisionism-science-and-technology-part-productive-forces>.

11. ZHANG, *supra* note 9, at 1.

12. *Id.* at 78-79.

13. *Id.* at 71-72.

14. *Id.*

15. *Id.* at 2.

16. *Id.*

17. *Id.* at 3.

18. *See id.* (describing the significant market position of some of China's state-owned oil companies).

19. *About CNPC*, CHINA NAT'L PETROLEUM CORP., http://www.cnpc.com.cn/en/aboutcnpc/aboutcnpc_index.shtml (last visited Nov. 10, 2014).

controlling shareholder of PetroChina, the fourth largest company in the world in terms of market capitalization as of 2015.²⁰ Its competitor, Sinopec, also an oil and gas producer, sits at number two on the list.²¹ Rounding out the list of the “big three” Chinese oil companies is CNOOC, which is the largest producer of offshore crude oil and natural gas in China.²²

China’s consistent growth in GDP and rapid urbanization has led to increasing demands for oil.²³ With a stagnant domestic oil industry, China has looked abroad to fulfill its oil needs.²⁴ The three major Chinese oil companies, along with others, have been heavily investing in overseas oil fields: CNPC/PetroChina ventures in Sudan and Ecuador, Sinopec in Azerbaijan and Saudi Arabia, and CNOOC in Indonesia.²⁵ However, few significant deals have worked out successfully.²⁶

The Chinese government has realized that reliance on imports diminishes the country’s independence, especially when so many of its costly energy ventures are tied up in the Middle East and Africa, where political turmoil threatens regional stability.²⁷ As a consequence, a high priority for Beijing is to develop more domestic energy resources.²⁸

Part of the solution to China’s increasing energy demand may be its oil shale reserves.²⁹ Chinese oil shale resources amount to

20. *Company Profile*, PETROCHINA CO. LTD., http://www.petrochina.com.cn/ptr/gsjj/gsjj_common.shtml (last visited Nov. 10, 2014); *Global 500 2014*, FORTUNE, <http://fortune.com/global500/2014/> (last visited Oct. 27, 2015).

21. *Global 500*, FORTUNE, <http://fortune.com/global500/> (last visited Mar. 21, 2016).

22. Alain Sepulchre, *Energy and Globalisation: Oil and Gas in China*, CHINA PERSPS., July-Aug. 2004, at 1, 13, <http://chinaperspectives.revues.org/pdf/2962>; *Company Profile*, CNOOC LTD., <http://www.cnoocld.com/col/col7261/index.html> (last visited Nov. 15, 2014); *Global 500 2014*, FORTUNE, <http://fortune.com/global500/2014/china-national-offshore-oil-79/> (last visited Oct. 27, 2015).

23. Sepulchre, *supra* note 22, at 4.

24. *Id.* at 5.

25. *Id.*

26. *Id.*

27. John Daly, *It’s Official – China Embraces Oil Shale and Fracking*, OILPRICE.COM (Sept. 2, 2012), <http://oilprice.com/Energy/Natural-Gas/Its-Official-China-Embraces-Oil-Shale-and-Fracking.html>.

28. *Id.*

29. *Id.*

720 billion tons, located in 80 deposits of 47 oil shale basins.³⁰ This adds up to 48 billion tons of shale oil.³¹ Proven oil shale reserves comprise about 36 billion tons.³² There is even speculation that China's actual resource may exceed the oil shale reserves in the United States.³³ According to China's NEA data, these oil shale reserves can produce 10 million tons of oil annually.³⁴ Oil shale may turn out to be crucial in safeguarding China's energy security.³⁵

In the United States, the fracking revolution opened up the possibility of oil production in regions previously thought to be inaccessible, such as the flatlands of Texas, North Dakota, and Pennsylvania.³⁶ Much of China's shale activity is "locked in mountainous regions in western China."³⁷ Despite these geographical differences, China has set its sights on U.S. firms for their advanced fracking technology to help unlock the country's shale wealth.³⁸ In 2010, CNOOC joined in a venture with Chesapeake Energy, a U.S. shale gas leader.³⁹ In January of 2012, Sinopec bought a one-third stake in several new ventures of shale gas pioneer Devon Energy for \$900 million.⁴⁰ Shell has also signed China's first production sharing contract for shale gas and is planning to build a \$12.6 billion refinery and petrochemical

30. OIL SHALE: OIL SHALE INDUSTRY, HISTORY OF THE OIL SHALE INDUSTRY, OIL SHALE GEOLOGY, OIL SHALE IN ESTONIA, OIL SHALE ECONOMICS, SHALE OIL, OIL SHALE RESERVES, OIL SHALE IN CHINA, OIL SHALE IN JORDAN, ENVIRONMENTAL IMPACT OF THE OIL SHALE INDUSTRY 103 (2010).

31. *Id.*

32. *Id.* at 104.

33. *Id.* at 103.

34. Daly, *supra* note 27.

35. *Id.*

36. Christina Larson, *China's Huge Shale-Gas Hopes Crash into Mountainous Reality*, BLOOMBERG BUS. (Aug. 8, 2014), <http://www.bloomberg.com/bw/articles/2014-08-08/chinas-shale-gas-production-target-cut-in-half-by-top-official>.

37. *Id.*

38. See Daly, *supra* note 27 (describing how Chinese firms are partnering with U.S. firms in the interest of technological transfer and the development of China's untapped shale reserves).

39. *Id.*

40. *Id.*

complex.⁴¹ This could potentially become the single largest foreign direct investment (“FDI”) in China’s history.⁴²

With Beijing intent on becoming more energy independent, as the United States has with its fracking revolution, foreign investments in the Chinese oil industry are bound to increase.

B. A Brief Look at Foreign Investments in China

For almost thirty years after the Communist Party came to power in 1949, China shunned direct participation by foreign capitalist entities in the country’s economy.⁴³ When Deng Xiaoping implemented the open-door policy in the late 1970s, the country had no legal framework for foreign investment activity.⁴⁴ However, during the years of 1979 to 1985, China promulgated more than fifty laws and regulations relating to foreign investment.⁴⁵ This new regulatory scheme included regulations governing joint development arrangements,⁴⁶ joint venture laws regarding direct equity investments,⁴⁷ and tax laws providing for sale of products from joint ventures.⁴⁸

Likewise, there were many updates to the regulatory framework related to the exploration and development of

41. *Id.*

42. *Id.*

43. Michael J. Moser, *Foreign Investment in China: The Legal Framework*, in FOREIGN TRADE, INVESTMENT, AND THE LAW IN THE PEOPLE’S REPUBLIC OF CHINA 106, 106 (Michael J. Moser ed., 1984).

44. *Id.*; Shigeo Kobayashi et al., *The “Three Reforms” in China: Progress and Outlook*, 45 RIM (Sept. 1999), <http://www.jri.co.jp/english/periodical/rim/1999/RIMe199904threereforms/> (describing Deng Xiaoping’s implementation of the “open door” policy).

45. Moser, *supra* note 43, at 106.

46. *See, e.g.*, Duiwai Hezuo Kaicai Haiyang Shiyou Ziyuan Tiaoli (对外合作开采海洋石油资源条例) [Foreign Cooperative Exploitation of Offshore Petroleum Resources Regulations] (promulgated by the Standing Comm. Nat’l People’s Cong., Jan. 30, 1979, effective Jan. 30, 1979).

47. *See, e.g.*, Zhongwai Hezi Jingying Qiyefa (中外合资经营企业法) [Joint Venture Law] (promulgated by the Standing Comm. Nat’l People’s Cong., July 8, 1979, effective July 8, 1979).

48. *See, e.g.*, Zhongwai Hezi Jingying Qiye Suodeshui Fa (中外合资经营企业所得税法) [Income Tax Law of the People’s Republic of China Concerning Chinese-Foreign Joint Ventures] (promulgated by Nat’l People’s Cong., Sept. 10, 1980, effective Sept. 10, 1980).

petroleum resources in China.⁴⁹ These additions included petroleum regulations, model contracts, tax rules, and special import tax and customs provisions.⁵⁰

China has been negotiating bilateral investment treaties (“BITs”) since the late 1990s.⁵¹ BITs are a very important legal regime that govern a country’s FDIs.⁵² They protect investments made in foreign countries by setting substantive rules that govern the host state’s treatment of the investment and establishing dispute resolution mechanisms in case there is a violation.⁵³

China currently has BITs with 130 countries.⁵⁴ However, the United States is not on this list.⁵⁵ China is currently in negotiations with both the United States and the European Union to establish a BIT.⁵⁶ However, U.S. Secretary of the Treasury, Jacob Lew, one of the brains behind the talks, estimates that a deal is still at least two years away.⁵⁷

49. See Michael J. Moser, *Offshore Oil Exploration in China: The Current Regulatory Regime*, in FOREIGN TRADE, INVESTMENT, AND THE LAW IN THE PEOPLE’S REPUBLIC OF CHINA, *supra* note 43, at 179, 180 (listing the most important considerations regarding foreign participation in the exploration and development of China’s offshore oil and gas resources).

50. *Id.*

51. AXEL BERGER, GERMAN DEV. INST., CHINA’S NEW BILATERAL INVESTMENT TREATY PROGRAMME 1, 10 (2008).

52. *Id.* at 1-2.

53. *Id.* at 2.

54. Jinbo Wang, *International Rules Restructuring and China’s Response*, CHINA INST. OF INT’L STUDIES (June 20, 2014), http://www.ciis.org.cn/english/2014-06/20/content_6996254.htm.

55. Most of the countries with which China has bilateral investment treaties are located in Asian, African, and South American nations. Even so, the absence of the United States from this list is glaring in view of the fact that China already has bilateral investment treaties with other major western powers, including Germany, France, Canada, and the United Kingdom. See *Bilateral Investment Treaties*, FOSHAN INV. PROMOTION AGENCY (Mar. 5, 2014), <http://fipa.gov.cn/chinas-bits-list/> (listing all of the bilateral investment treaties China has with other countries, which does not include the United States).

56. Kenneth Rapoza, *China Says U.S. Investment Treaty on ‘Fast Track’*, FORBES (July 10, 2014, 9:57 AM), <http://www.forbes.com/sites/kenrapoza/2014/07/10/china-says-u-s-investment-treaty-on-fast-track/>; *EU and China Begin Investment Talks*, EUROPEAN COMMISSION (Jan. 20, 2014), http://europa.eu/rapid/press-release_IP-14-33_en.htm.

57. Rapoza, *supra* note 56.

Without a BIT as an anchor, potential foreign investors will have to look at the applicable laws and regulations of China in order to gauge the security of their investments.⁵⁸ However, the Chinese legal framework is a maze of unpredictable obstacles, overbearing government supervision, conflicting laws, and legislative loopholes.⁵⁹ In order to attract more foreign investment, especially in long-term ventures that oil and gas projects so often are, the Chinese government must eliminate conflicting regulations, create more monetary incentives for foreign enterprises, and implement clearer laws so that less is left up to the judgment of state agencies.⁶⁰ Most importantly, the Chinese government should de-monopolize the domestic petroleum industry.⁶¹

58. See Berger, *supra* note 51, at 1-14 (discussing China's modern trend moving away from a restrictive approach that preserves the sovereign right of host states to maintain national laws and regulations on the entry and operation of foreign investors through the use of bilateral investment treaties that provide international investment protection to foreign investors).

59. Some of the challenges foreign investors face include an unpredictable business climate, unclear and inconsistent enforcement of laws and regulations and an unreliable legal system with numerous legislative restrictions, loopholes, and contradictory measures. U.S. DEP'T OF STATE, CHINA INVESTMENT CLIMATE STATEMENT 1, 3-6, 8-9 (2015); George Chen, *Legal Loopholes Prompt China to Delay Shanghai Free-Trade Zone Rules*, SOUTH CHINA MORNING POST (Aug. 5, 2013, 12:00 AM), <http://www.scmp.com/business/banking-finance/article/1294289/legal-loopholes-prompt-china-delay-shanghai-free-trade-zone>.

60. For an idea of where China is and what still must be done compare INFO. OFFICE OF THE STATE COUNCIL OF CHINA, *China's Policy on Mineral Resources*, CHINA.ORG.CN (Dec. 23, 2003), <http://www.china.org.cn/english/2003/Dec/83092.htm>, which details China's policy of encouraging foreign businesses to invest in mineral resources by annulling the administrative statutes and departmental rules that are incompatible with the WTO rules, emphasizing greater financial support for enterprises with foreign investment, clarifying approval procedures for foreign investment, and standardizing the behavior of governments at all levels in exercising management over foreign investment, with, *supra* note 59.

61. Bao Chang & Du Juan, *Break Up of State Monopoly?*, CHINA DAILY EUROPE, http://europe.chinadaily.com.cn/business/2013-09/26/content_16994813.htm (last updated Sept. 26, 2013); see also U.S. DEP'T OF STATE, *supra* note 59, at 3, 5 (describing China's legal framework that provides the country with discretion to restrict foreign investment that would compete with state-sanctioned monopolies).

III. A CLOSER LOOK AT FOREIGN INVESTMENTS IN CHINESE OIL

The Chinese state-owned oil companies seem to prefer production sharing agreements for energy exploration.⁶² CNPC and Shell signed a production sharing contract for shale gas exploration in 2012.⁶³ On July 16, 2013, CNOOC signed its 200th foreign oil production sharing contract with British Petroleum.⁶⁴

Production sharing agreements have been long-used in international petroleum transactions.⁶⁵ Historically, the classic structure was a concession by the host government.⁶⁶ The foreign investor would pay a mixture of up-front fees, a royalty based on the amount and value of the resource extracted, and taxes on its revenues and profits, as well as fees for various services provided by the government.⁶⁷ The international oil company owned the resource.⁶⁸ During the first half of the nineteenth century, most energy projects in the Middle East and Latin America were concessions obtained by an international oil company.⁶⁹

However, during the second half of the nineteenth century, things changed.⁷⁰ National governments increasingly resisted the idea of foreign ownership of its natural resources.⁷¹ From this

62. See U.S. ENERGY INFO. ADMIN., CHINA INTERNATIONAL ENERGY DATA AND ANALYSIS 1, 4-5, 16-17, 20, 22 (2015), http://www.eia.gov/beta/international/analysis_includes/countries_long/China/china.pdf (detailing how China's major national oil companies, CNPC, Sinopec, and CNOOC, have granted greater access to international oil companies mainly through production sharing contracts).

63. *CNPC and Shell Sign First Shale Gas Production Sharing Contract in China*, SHELL GLOBAL (Mar. 20, 2012), <http://www.shell.com/global/aboutshell/media/news-and-media-releases/2012/cnpc-shell-shale-gas-psc-china-20032012.html>.

64. *CNOOC Signs 200th Foreign Oil Production-Sharing Contract*, REUTERS (July 16, 2013, 7:11 AM), <http://www.reuters.com/article/2013/07/16/china-cnooc-bp-idUSL6N0FM1W620130716>.

65. See ERNEST E. SMITH ET AL., MATERIALS ON INTERNATIONAL PETROLEUM TRANSACTIONS 463 (3d ed. 2010) (discussing how production sharing contracts have been a popular form of developing a country's reserves via contracting with international oil companies since the late 1950s and early 1960s).

66. RICHARD N. DEAN ET AL., DOING BUSINESS IN EMERGING MARKETS 244 (2d ed. 2010).

67. *Id.*

68. *Id.*

69. *Id.*

70. *Id.*

71. *Id.* at 245.

revolution rose the production sharing agreement.⁷² In a production sharing agreement, the host government grants to the international oil company a contractual right to explore in a specified area in exchange for a share of production.⁷³ The company, in turn, has the opportunity to recover its costs and a possible profit.⁷⁴

Production sharing agreements usually involve the host country's national oil company or government agency as the overseer of the venture.⁷⁵ National oil companies keep the title to the block and monitor and approve the activities of the international oil company to learn about the operation so that they may eventually take over all operations.⁷⁶ An international oil company should be aware when entering into a production sharing agreement that it has fewer rights than it would have under a concession.⁷⁷ The international oil company will not receive title or interests to the oil in any legal sense.⁷⁸ Instead, it will receive cost oil and a share of profit oil at some point downstream of the wellhead.⁷⁹

Under the usual terms of a production sharing agreement, the international oil company must provide all materials, technology, capital, and labor.⁸⁰ All of the equipment and infrastructure installed by the international oil company will transfer to the national oil company or host government at the end of the

72. *Id.*

73. SMITH ET AL., *supra* note 65, at 463. Production sharing agreements are also called production sharing contracts, exploration-production sharing agreements, and exploration and development-production sharing agreements. *Id.*

74. *Id.*

75. *Id.*

76. *Id.*

77. *Id.* at 464.

78. *Id.*

79. *Id.* Cost oil is defined as a portion of produced oil that the operator applies on an annual basis to recover defined costs specified by a production sharing contract. *Oilfield Glossary*, SCHLUMBERGER, http://www.glossary.oilfield.slb.com/Terms/p/profit_oil.aspx (last visited Nov. 12, 2015). Product oil is defined as the amount of production, after deducting cost oil production allocated to costs and expenses that will be divided between the participating parties and the host government under the production sharing contract. *Oilfield Glossary*, SCHLUMBERGER, http://www.glossary.oilfield.slb.com/Terms/p/profit_oil.aspx (last visited Feb. 27, 2016).

80. SMITH ET AL., *supra* note 65, at 464.

contract term.⁸¹ The international oil company bears all the risk in such a project.⁸²

A. *Oil Ownership and Upstream Production*

At present, China has implemented state ownership of all oil resources, according to the Mineral Resources Law.⁸³ The exploration of oil, natural gas, radioactive minerals, and any other minerals specified in the law will be examined and approved by the relevant departments authorized by the State Council.⁸⁴ The same department will also issue mining licenses for such operations.⁸⁵ The right to explore and develop onshore and offshore oil and gas resources is reserved to the three major state-owned companies.⁸⁶ Foreign enterprises are prohibited from infringing upon this right.⁸⁷

According to the existing system, state-owned enterprises must first apply to the Ministry of Land for exploration and to

81. *Id.*

82. *See id.* (discussing how host governments use production sharing agreements to attract an international oil company's capital and technological expertise to develop their native reserves, while retaining their title to the resources and not risking their own capital).

83. Kuangchan Ziyuanfa (矿产资源法) [Mineral Resources Law] (promulgated by the Standing Comm. Nat'l People's Cong., Mar. 19, 1986, effective Oct. 1, 1986), art. 3 [hereinafter Mineral Resources Law].

84. *Id.* art. 16. The State Council is an executive authority with plenary power to oversee agency actions and promulgate regulations in furtherance of the National People's Congress. *See generally* State Structure of the People's Republic of China: The State Council, Nat'l People's Congress of China (last visited March 21, 2016), http://www.npc.gov.cn/englishnpc/stateStructure/2007-12/06/content_1382098.htm.

85. Mineral Resources Law, *supra* note 83, art. 16.

86. *See* Duiwaihezuo Kaicai Lushang Shiyou Ziyuan Tiaoli (对外合作开采陆上石油资源条例) [Foreign Cooperation Exploitation of Onshore Petroleum Resources] (promulgated by the Standing Comm. Nat'l People's Cong., Sept. 23, 2001, effective Sept. 23, 2001), art. 6 (prescribing that CNPC and Sinopec shall have the exclusive right to conduct petroleum exploration of onshore petroleum resources); Duiwaihezuo Kaicai Haiyang Shiyou Ziyuan Tiaoli (对外合作开采海洋石油资源条例) [Foreign Cooperation Exploitation of Offshore Petroleum Resources] (promulgated by the Standing Comm. Nat'l People's Cong., Sept. 23, 2001, effective Sept. 23, 2001), art. 6 (prescribing that CNOOC shall take charge and have the exclusive right over the exploration of offshore petroleum resources in China).

87. *See* Mineral Resources Law, *supra* note 83, art. 19 (stating that no unit or individual may enter and carry out mining activities in the mining area of a mining enterprise that has already acquired the mining right for such area).

obtain mining licenses, unless the block is reserved for other uses;⁸⁸ then they can decide whether they will perform the exploration projects by themselves or through production sharing contracts with international oil companies.⁸⁹

International oil companies can only participate in oil and gas exploration and development in China through a production sharing contract.⁹⁰ Under this system, strict restrictions for cooperative exploitation of onshore and offshore petroleum resources are imposed by the Mineral Resources Law and other supporting regulations.⁹¹ Sinopec, CNPC, CNOOC and a few state-owned mining companies enjoy this privilege.⁹² According to the Ministry of Land's data, two major Chinese oil companies have registered block areas reaching nearly 4.7 million square kilometers, accounting for almost half of the land area of China.⁹³

CNOOC dominates offshore oil and gas exploration, development, and sales.⁹⁴ CNOOC is China's main offshore oilfield development enterprise, owning the vast majority of China's offshore oil and gas, and is the main player in China's offshore exploration and development activities.⁹⁵ However, CNOOC still lacks core services and products, which is what provides business opportunities for an international oil company

88. Suling Wang & Jiange Li, *Research of the Effect of the Monopoly of China Natural Gas Industry in Shale Gas Development and the Corresponding Countermeasures*, 6 J. CHEM. & PHARMA. RES. 504, 506-07 (2014).

89. *Id.*

90. Foreign Cooperation Exploitation of Offshore Petroleum Resources, art. 8; Foreign Cooperation Exploitation of Onshore Petroleum Resources, art. 8.

91. See Mineral Resources Law, *supra* note 83, arts. 3, 6 (prescribing certain requirements for obtaining rights to exploration and mining of mineral sources and setting forth that any change to a mining right due to the formation of an equity joint venture or a contractual joint venture is subject to approval in accordance with the law).

92. See U.S. ENERGY INFO. ADMIN., *supra* note 62, at 4-5.

93. *Why Conoco Phillips Is So "Awesome"*, TENCENT (Sept. 4, 2011), <http://view.news.qq.com/zt2011/kangfei/index.htm> (translated by author).

94. China's oil and natural gas sectors are dominated by the three principal state-owned oil and gas companies, of which CNOOC is the primary stakeholder of offshore zone exploration rights. U.S. ENERGY INFO. ADMIN., *supra* note 62, at 4-5, 7, 16, 18.

95. *CNOOC's Opening Up Oil and Gas Block, Opening up over 100,000 Square Kilometers*, NETEASE (Oct. 9, 2013, 4:56 PM), <http://money.163.com/13/1009/16/9AOR9DRP002524SO.html#from=keyscan> (translated by author).

in China.⁹⁶ International oil companies can directly cooperate with CNOOC on offshore oil exploration and development projects.⁹⁷

Due to the nature of China's regulatory framework, an international oil company that engages in a joint venture with a Chinese state-owned oil company must be wary of a possible unequal bargaining position and substantial governmental oversight.⁹⁸ A foreign enterprise should be prepared to have to jump through regulatory hoops in China.

B. Petroleum-Related Laws and Regulations

China's current oil and gas laws and regulations were mostly implemented during the country's transition from a planned economy to a market economy.⁹⁹ They were enacted to meet the development needs of the industry at the time to protect economic development.¹⁰⁰

1. Marine Environment Protection Law

The Marine Environment Protection Law of the People's Republic of China was formulated in 1982 and amended twice, once in 1999 and again in 2013.¹⁰¹ It specifies that only oily waste

96. Chinese oil and gas companies lack expertise and experience in the necessary technologies, which has led nationally-owned oil companies like CNOOC to seek advanced international firms' expertise and technology in exploring and extracting unconventional hydrocarbons; this provides "an evolving opportunity landscape to international [oil and gas] stakeholders." Tim Quijano, *CNOOC: Expansion into Unconventional Expertise*, CHINA ANALYST, Apr. 2014, <http://www.thebeijingaxis.com/tca/editions/the-china-analyst-apr-2014>.

97. *Why Conoco Phillips Is So "Awesome"*, *supra* note 93.

98. *See* Sepulchre, *supra* note 22, at 2, 11-12 (describing how China's market is still in transition from a base of heavy state interventionism and protectionism and detailing its prevailing numerous restrictions and regulations which combined limit the scope of a fair playing field).

99. *See infra* Section II.B.

100. *See infra* Section II.B.

101. *See generally* Haiyang Huanjing Baohufa (海洋环境保护法) [Marine Environmental Protection Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 23, 1982) (stating that the law was revised at the 13th Meeting of the Standing Committee of the Ninth National People's Congress on December 25, 1999); *see also* Zhuxiling Dibahao (主席令第八号) [Decision of the Standing Committee of the National People's Congress on Amending Seven Laws Including the Marine Environment

water and oil mixtures which have been properly treated so as to meet discharge standards may be discharged into the sea from offshore drilling vessels and platforms.¹⁰² Residual and waste oil remaining after the treatment process must be recycled and cannot be discharged into the sea.¹⁰³ Any discharge of water-based mud, other non-toxic compound mud, and drilling debris must conform to relevant provisions of State regulations.¹⁰⁴ In the event of offshore well-testing, the oil and gas shall be thoroughly burned.¹⁰⁵

In general, the disposal of industrial garbage must not cause pollution to the marine environment.¹⁰⁶ Companies engaged in offshore petroleum exploration should formulate contingency plans to control any accidental oil spills so as not to pollute the environment.¹⁰⁷ However, federal regulations are still lacking in many areas, such as what the set standards are.¹⁰⁸ The State often leaves such matters up to the governmental agency handling the issue, giving an agency the power of determining whether or not the law has been violated.¹⁰⁹

2. Mineral Resources Law & Rules for Implementation

Together, the Mineral Resources Law and the Rules for the Implementation of the Mineral Resources Law specify that the State allows foreign companies, enterprises, and other economic

Protection Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 28, 2013) (stating that along with numerous other laws, the Marine Environment Protection Law was amended on December 28, 2013).

102. Marine Environmental Protection Law, art. 51. When the waste is discharged after treatment, the discharged oil content may not exceed the standards set by the State. *Id.*

103. *Id.* Oil-based mud and toxic compound mud used in drilling must not be disposed in the sea. *Id.*

104. *Id.*

105. *Id.* art. 53.

106. *Id.* art. 52.

107. *Id.* art. 54.

108. For example, Article 52 prescribes that the State set quality standards that account for the economy, available technologies, and national and local standards. *Id.* However, no specific standards are mentioned in the law.

109. *See id.* art. 5 (establishing that certain administrative departments will have the responsibility over the supervision and control of the marine environment in their respective areas).

organizations as well as individuals to invest in exploration and development of mineral resources within China and offshore areas under its jurisdiction.¹¹⁰ Foreign companies and individuals should consider these two laws in tandem when investing in China's petroleum market so as not to violate any regulations. Where laws or administrative rules and regulations provide otherwise on foreign-funded exploration and mining of mineral resources, such provisions shall prevail.¹¹¹

3. Land Administration Law

When the project reaches the stage of geological surveys and construction, the Land Administration Law specifies that temporary use of state-owned land or land collectively owned by farmers will be subject to the approval of the Department of Land Administration at or above the county level.¹¹² There are additional considerations for temporary use of land within an urban planning zone – consent of the appropriate department of urban planning should be sought prior to seeking approval from the Department of Land Administration.¹¹³ This law is applicable to the land used by Chinese-foreign equity joint ventures, Chinese-foreign contractual joint ventures, and foreign capital enterprises.¹¹⁴

4. Environmental Protection Law

One of the landmark regulations related to China's burgeoning oil industry is the Environmental Protection Law promulgated in 1989.¹¹⁵ The law was finally updated a quarter

110. Mineral Resources Law, *supra* note 83, art. 1; Kuangchan Ziyuanfa Shishi Xize (矿产资源法实施细则) [Rules for Implementation of the Mineral Resources Law] (promulgated by the Standing Comm. Nat'l People's Cong., Mar. 26, 1994, effective Mar. 26, 1994), art. 7.

111. Mineral Resources Law, *supra* note 83, art. 50.

112. Tudi Guanlifa (土地管理法) [Land Administration Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 28, 2004, effective Aug. 28, 2004), art. 57.

113. *Id.*

114. *Id.* art. 85.

115. Huanjing Baohufa (环境保护法) [Environmental Protection Law] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 26, 1989, effective Dec. 26, 1989; amended by the Standing Comm. Nat'l People's Cong., Apr. 24, 2014, effective Jan. 1, 2015).

century after its passage.¹¹⁶ The amendments grant more power to environmental authorities and impose harsher punishments for polluters, such as detaining executives who do not complete environmental impact assessments or ignore warnings to stop polluting.¹¹⁷ The new law came into effect on January 1, 2015.¹¹⁸

The law specifies that enterprises, public institutions, and other producers and business operators that discharge pollutants shall take measures to prevent and control the environmental pollution caused by waste gas, waste water, waste residues, dust, malodorous gases, radioactive substances and noise, vibration and electromagnetic radiation generated during production, construction or other activities.¹¹⁹ Enterprises and public institutions that discharge pollutants shall each establish an environmental protection accountability system to identify the responsibilities of their executives and managers.¹²⁰

It is the responsibility of the appropriate environmental authorities to conduct proper risk control, emergency preparation, emergency response, and post-emergency restoration for environmental accidents.¹²¹ Local officials may be demoted or terminated if they are found to have covered up environmental-related wrongdoing.¹²² However, even with the new amendments, environmental groups fear that implementation of these rules will be difficult.¹²³ The new amendments having only come into effect in the beginning of 2015, the success or failure of this legislative attempt remains to be seen.

116. Jonathan Kaiman, *China Strengthens Environmental Laws*, THE GUARDIAN (Apr. 25, 2014, 11:58 AM), <http://www.theguardian.com/environment/2014/apr/25/china-strengthens-environmental-laws-polluting-factories>.

117. *Id.*

118. *Id.*

119. Environmental Protection Law, art. 42.

120. *Id.* This is, ostensibly, an effort to ensure that the responsible executives and managers for a given incident are held accountable under the provision's detention provisions. *See supra* note 116 and accompanying text.

121. *Id.* art. 47.

122. Kaiman, *supra* note 116.

123. *See id.* (discussing China's close to irreversible environmental conditions).

5. Law on the EEZ and Continental Shelf

The Law on the Exclusive Economic Zone and the Continental Shelf governs exploration of natural resources within China's exclusive economic zone and continental shelf.¹²⁴ The law covers international parties as well.¹²⁵ Pursuant to the United Nations Convention on the Law of the Sea (UNCLOS) and customary international law, China's exclusive economic zone extends up to 200 nautical miles beyond the limits of the state's territorial sea, which itself must be within 12 nautical miles of the state's coastline.¹²⁶

Alongside the Law on the Exclusive Economic Zone and the Continental Shelf, the Law on the Administration of the Use of Sea Areas delineates how to gain rights to use sea areas.¹²⁷ The right to use sea areas can be obtained through bidding or auction.¹²⁸ The winning bidder may use the sea area for mining for a maximum of 30 years, which may be renewed upon application for an extension submitted no later than two months prior to the expiration date set by the government.¹²⁹ This extension will usually be approved unless there are extenuating circumstances.¹³⁰

6. Pipeline Regulation

In 2010, the Chinese legislature promulgated the Law on the Protection of Oil and Natural Gas Pipelines. The law covers planning and construction, protection of pipeline operations, handling of pipeline construction projects interconnected with

124. Zhuanshu Jingjiqu He Dalu Jiafa (专属经济区和大陆架法) [Law on the Exclusive Economic Zone and the Continental Shelf] (promulgated by the Standing Comm. Nat'l People's Cong., June 26, 1998, effective June 26, 1998), art. 1.

125. *Id.* art. 7.

126. United Nations Convention on the Law of the Sea arts. 3-15, 57, Dec. 10, 1982, 1833 U.N.T.S. 397, 419; Law on the Exclusive Economic Zone and the Continental Shelf art. 2.

127. Haiyu Shiyong Guanlifa (海域使用管理法) [Law on the Administration of the Use of Sea Areas] (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 27, 2001, effective Jan. 1, 2002), art. 1.

128. *Id.* art. 20.

129. *Id.* arts. 25 & 26 (stating "on the basis of the purposes of their use. . . 30 years for the salt and mining industries").

130. *Id.*

other construction projects, and legal liability.¹³¹ A key feature of the new law is that it authorizes the State Council to issue specific regulations to protect China's offshore pipelines while still preserving its focus on land pipelines.¹³² The law applies to pipelines that transport oil and natural gas but does not apply to protection of natural gas pipelines in cities and towns or pipelines near oil refineries, chemical plants, and other industrial work zones.¹³³

C. *Laws and Regulations Governing Foreign Investment*

China is trying to raise its global competitiveness by loosening restrictions on foreign investment.¹³⁴ The Chinese legislature has promulgated more than twenty regulations and rules relating to mineral resources.¹³⁵ The two most important for foreign investors are Exploitation of Offshore Petroleum Resources in Cooperation with Foreign Parties Regulations ("Offshore FPR") and Exploitation of Onshore Petroleum Resources in Cooperation with Foreign Parties Regulations ("Onshore FPR").¹³⁶ Both regulations were promulgated and became effective at the same time.

Offshore FPR specifies that CNOOC, by means of calling for bids and signing petroleum contracts, can cooperate with foreign

131. Wendy Zeldin, *China: New Law on Oil and Natural Gas Pipelines*, LIBRARY OF CONGRESS (July 6, 2010), <http://www.loc.gov/law/foreign-news/article/china-new-law-on-oil-and-natural-gas-pipelines/>.

132. *Id.*

133. Law on the Protection of Oil and Natural Gas Pipelines, art. 2.

134. Alex Lee, *China Draft Rules Ease Limits on Foreign Investment*, REUTERS (Nov. 5, 2014, 2:37 AM), <http://www.reuters.com/article/2014/11/05/us-china-investment-idUSKBN0IP01Z20141105>.

135. INFO. OFFICE OF THE STATE COUNCIL OF CHINA, *supra* note 60.

136. Duiwaihezuo Kaicai Haiyang Shiyou Ziyuan Tiaoli (对外合作开采海洋石油资源条例) [Exploitation of Offshore Petroleum Resources in Cooperation with Foreign Parties Regulations] (promulgated by the Standing Comm. Nat'l People's Cong., Sept. 23, 2001, effective Sept. 23, 2001); Duiwaihezuo Kaicai Lushang Shiyou Ziyuan Tiaoli (对外合作开采陆上石油资源条例) [Exploitation of Onshore Petroleum Resources in Cooperation with Foreign Parties Regulations] (promulgated by the Standing Comm. Nat'l People's Cong., Sept. 23, 2001, effective Sept. 23, 2001).

enterprises to explore petroleum resources.¹³⁷ The law states that China's government will protect the investments of foreign enterprises participating in the cooperative exploration of offshore petroleum resources, the profits due to them, and the activities involved in the exploration.¹³⁸

In the 2011 amended version, these Sino-foreign joint ventures involving exploration of offshore petroleum resources will pay taxes according to the law of resources.¹³⁹ The foreign contractor may have its oil shipped abroad, and may also lawfully recover investment, profits, and other legitimate income remitted abroad.¹⁴⁰

To attract more international investment and to encourage development of offshore petroleum resources, China's Ministry of Finance promulgated the Provisions Concerning the Payment of Royalties for the Exploitation of Offshore Petroleum Resources in 1989.¹⁴¹ According to these provisions, royalties should be calculated based on the gross output of crude oil or natural gas produced every calendar year from each oil and gas field.¹⁴² Operators shall act as agents by withholding the royalties and hand them over to CNOOC, which, in turn, pays the royalties to the government.¹⁴³

Onshore FPR governs onshore oil and gas ventures.¹⁴⁴ CNPC and Sinopec are jointly responsible for the exploration of onshore oil resources in cooperation with foreign parties.¹⁴⁵ They are responsible for negotiating, signing, and carrying out contracts with foreign enterprises for cooperative exploration of onshore oil

137. Exploitation of Offshore Petroleum Resources in Cooperation with Foreign Parties Regulations, art. 7.

138. *Id.* art. 3.

139. *Id.* art. 10.

140. *Id.* art. 9.

141. Kaicai Haiyang Shiyu Ziyuan Jiaona Kuangqu Shiyongfeide Guiding (开采海洋石油资源缴纳矿区使用费的规定) [Provisions Concerning the Payment of Royalties for the Exploitation of Offshore Petroleum Resources] (promulgated by the Standing Comm. Nat'l People's Cong., Jan. 1, 1989, effective Jan. 1, 1989), art. 1.

142. *Id.* at art. 3.

143. *Id.* at art. 5.

144. Exploitation of Onshore Petroleum Resources in Cooperation with Foreign Parties Regulations, art. 4.

145. *Id.* art. 7.

resources and are entitled to exclusive rights for oil exploration, development, and production in cooperation with foreign enterprises as well.¹⁴⁶ The oil received or purchased by the foreign contractor may be shipped abroad in accordance with the relevant provisions of the State and as agreed to in the contract.¹⁴⁷

Even with Beijing's stated intentions and these legislative efforts to encourage foreign investment, the government is still reluctant to cede too much of its control over the economy.¹⁴⁸ In comparison to doing business in more developed nations, foreign investors in China should expect stricter regulation from the government and state agencies.¹⁴⁹

D. Implementing the Mineral Resources Law

In 1998, the State Council issued three administrative regulations: 1) Measures for the Area Registration Administration of Mineral Resource Exploration and Survey, 2) Measures for the Registration Administration of Mineral Resource Exploitation, and 3) Measures for the Administration of Transfers of Mineral Exploration Rights and Mining Rights.¹⁵⁰ These regulations are important in implementing the Mineral Resources Law.

The first regulation specifies that whoever engages in the exploration and survey of mineral resources must register with

146. *Id.*

147. *Id.* art. 15.

148. Lee, *supra* note 134.

149. See *Overseas Business Risk – China*, Gov.UK (Jul. 10, 2015), <https://www.gov.uk/government/publications/overseas-business-risk-china/overseas-business-risk-china> (discussing recent changes in the Chinese regulatory and economic environments with respect to business).

150. Kuangchan Ziyuan Kancha Qukuai Dengji Guanli Banfa (矿产资源勘查区块登记管理办法) [Measures for the Area Registration Administration of Mineral Resources Exploration and Survey] (promulgated by the Standing Comm. Nat'l People's Cong., Feb. 12, 1998, effective Feb. 12, 1998); Kuangchan Ziyuan Kaicai Dengji Guanli Banfa (矿产资源开采登记管理办法) [Measures for the Registration Administration of Mineral Resources Exploitation] (promulgated by the Standing Comm. Nat'l People's Cong., Feb. 12, 1998, effective Feb. 12, 1998); Tankuangquan Caikuangquan Zhuanrang Guanli Banfa (探矿权采矿权转让管理办法) [Measures for the Administration of Transfer of Mineral Exploration Right and Mining Right] (promulgated by the Standing Comm. Nat'l People's Cong., Feb. 12, 1998, effective Feb. 12, 1998).

the Department of Geology and Mineral Resources.¹⁵¹ The department then issues an exploration and survey permit upon examination and consent by the State Council.¹⁵² An exploration and survey permit is valid for a maximum of three years.¹⁵³ However, for petroleum and natural gas projects, an exploration and survey permit is valid for a maximum of seven years.¹⁵⁴ If an extension is needed, the holder of the exploration right must register for an extension, not to exceed two years from the termination of the prior permit, at least thirty days prior to the expiration date of the permit.¹⁵⁵ The maximum duration of a mining permit and subsequent extensions for continuous exploration of petroleum and natural gas is fifteen years.¹⁵⁶ In case of a joint venture between a Chinese company and a foreign entity, the Chinese company is required to submit the relevant documents.¹⁵⁷

Article 17 of the regulation also outlines mandatory minimum work obligations during the exploratory and survey phase:

- (1) 2,000 RMB / square kilometer in the first year;
- (2) 5,000 RMB / square kilometer in the second year;
- (3) 10,000 RMB / square kilometer starting from the third year.¹⁵⁸

If the minimum work obligation for the current year has been exceeded, the excess can be rolled over and counted toward the following year's obligations.¹⁵⁹ These mandatory work obligations are likely to be very restrictive for an international oil company, depending on the size of the field being explored.¹⁶⁰ It is unclear

151. Measures for the Area Registration Administration of Mineral Resources Exploration and Survey, art. 4.

152. *Id.*

153. *Id.* art. 10.

154. *Id.*

155. *Id.*

156. *Id.*

157. *Id.* art. 38.

158. *Id.*

159. *Id.*

160. See ALLEN & OVERY LLP, GUIDE TO EXTRACTIVE INDUSTRIES DOCUMENTS 8 (2013) (detailing the risk typically assumed by international oil companies bound by agreements that contain minimum work obligations).

if foreign investors will have the opportunity to negotiate more favorable contractual terms with China's state-owned oil companies when formulating the joint operating agreement.

The second regulation states that a mining permit and registration fee is required for exploring petroleum and natural gas resources.¹⁶¹ Article 7 delineates how long a permit is valid.¹⁶² It states that the size of the mine will determine the maximum validity of a mining permit: thirty years for a "big-size" mine, twenty years for a "medium-size" mine, and ten years for a "small-size" mine.¹⁶³ However, the regulation fails to define what qualifies as big, medium, and small.¹⁶⁴ It would be better if the law is amended to define these terms to avoid confusion and conflict.

Articles 5 and 6 of the third regulation list the conditions that must be met in order to transfer one's mineral exploration right to another, including fulfilling minimum work obligations and paying all necessary fees.¹⁶⁵

E. When Investing in the Chinese Oil Market

In general, a foreign investor has three main ways to invest in China's oil industry: investing in upstream exploration and production, buying shares in Chinese oil companies, or investing in midstream and downstream activities through joint ventures.¹⁶⁶

161. Measures for the Registration Administration of Mineral Resources Exploitation, arts. 3 (mining permit) & 27 (registration fee).

162. *Id.* art. 7.

163. *Id.*

164. The definitions are set internally by the organ that deals with mineral policy. *Id.* art. 16.

165. Measures for the Administration of Transfer of Mineral Exploration Right and Mining Right, arts. 5 & 6.

166. See U.S. ENERGY INFO. ADMIN., *supra* note 62, at 16 (outlining Chinese incentives for foreign investment in downstream and upstream petroleum investment); see also John Mitchell et al., *What Next for the Oil and Gas Industry?*, CHATHAM HOUSE (2012), https://www.chathamhouse.org/sites/files/chathamhouse/public/Research/Energy,%20Environment%20and%20Development/1012pr_oilgas.pdf ("The privatization of parts of the Chinese oil industry enables private investors to buy shares in some Chinese oil companies.").

Joint ventures are utilized internationally for exploring and developing natural resources.¹⁶⁷ Its most prominent features are high risk, high investment, and high returns. In China, instead of creating a joint venture company, the international oil company and the Chinese national oil company remain separate legal entities.¹⁶⁸ The Chinese government retains sovereignty over all of its natural resources with the foreign-owned company receiving its share of proceeds pursuant to the production sharing agreement.¹⁶⁹ Production sharing agreements become effective after approval by the Ministry of Foreign Trade and Economic Cooperation.¹⁷⁰ The different stages of a petroleum operation are generally divided into exploration, development, and production.¹⁷¹

During the exploration phase, the international oil company bears all costs and risks.¹⁷² If there is no commercial discovery,

167. See Robert James, *Strategic Alliances Between National and International Oil Companies* 13 (Stanford Program on Energy and Sustainable Development, Working Paper No. 104, 2011) (describing “strategic alliances” as an immensely popular type of joint venture worldwide).

168. See *Duiwaihezuo Kaicai Haiyang Shiyou Ziyuan Tiaoli* (对外合作开采海洋石油资源条例) [Exploitation of Offshore Petroleum Resources in Cooperation with Foreign Parties Regulations], art. 6-7 (describing the nature of cooperation between CNOOC and international oil companies); *Duiwaihezuo Kaicai Lushang Shiyou Ziyuan Tiaoli* (对外合作开采陆上石油资源条例) [Exploitation of Onshore Petroleum Resources in Cooperation with Foreign Parties Regulations], art. 7 (describing the relationship between the two entities as contractual rather than the creation of a joint venture company).

169. See, e.g., *Exploitation of Offshore Petroleum Resources in Cooperation with Foreign Parties Regulations*, art. 1 (stating that “all petroleum resources in the internal waters, territorial sea and continental shelf of the PRC and in all sea areas within the limits of national jurisdiction” are owned by China); *Exploitation of Onshore Petroleum Resources in Cooperation with Foreign Parties Regulations*, art. 3 (stating that oil resources within China’s territory all belong to the state).

170. *Exploitation of Offshore Petroleum Resources in Cooperation with Foreign Parties Regulations*, art. 7; *Exploitation of Onshore Petroleum Resources in Cooperation with Foreign Parties Regulations*, art. 8.

171. *Exploitation of Offshore Petroleum Resources in Cooperation with Foreign Parties Regulations*, art. 26.

172. *Id.*

the contract is terminated.¹⁷³ China is not liable for compensating losses occasioned by the cancellation.¹⁷⁴

If there is a commercial discovery, the project will continue onto the development phase.¹⁷⁵ China participates only by jointly developing with foreign investors according to an agreed proportion of co-financed investments (generally, China invests less than 51%).¹⁷⁶ After entering full production phase, the international oil company is required to pay the relevant taxes and royalties.¹⁷⁷

The Onshore FPR states that China will not expropriate the investment or income of foreign enterprises.¹⁷⁸ Interestingly enough, there is no such provision in the Offshore FPR.¹⁷⁹

Another cautionary note is that even though the Onshore FPR states that there will be no expropriation, there is a loophole.¹⁸⁰ Under Article 5, the state retains the right to expropriate a part or all of the oil receivable by foreign enterprises under special circumstances or where required by public interest.¹⁸¹ However, the rest of the regulation fails to define what constitutes “special circumstances” or what kinds of social public interests would trigger expropriation.¹⁸² Without a proper

173. *Id.* art. 8

174. *See id.* (stating that foreign oil companies are responsible for all prospecting and bearing of risk).

175. *See id.* (describing the discovery of commercial oil as a condition for investment cooperation with CNOOC).

176. *See* U.S. ENERGY INFO. ADMIN., *supra* note 62, at 16 (stating that CNOOC has the right to acquire up to a fifty-one percent working interest in offshore discoveries jointly developed).

177. Exploitation of Offshore Petroleum Resources in Cooperation with Foreign Parties Regulations, art. 10.

178. Duiwaihezuo Kaicai Lushang Shiyou Ziyuan Tiaoli (对外合作开采陆上石油资源条例) [Exploitation of Onshore Petroleum Resources in Cooperation with Foreign Parties Regulations] (promulgated by the Standing Comm. Nat'l People's Cong., Sept. 23, 2001, effective Sept. 23, 2001), art. 5.

179. *See* Exploitation of Offshore Petroleum Resources in Cooperation with Foreign Parties Regulations.

180. Exploitation of Onshore Petroleum Resources in Cooperation with Foreign Parties Regulations, art. 5.

181. *Id.*

182. *See id.* (lacking definitions or explanations of “special circumstances” and “social public interests”).

definition, the Chinese government may choose to expropriate a foreign entity's investments at any time under so-called "special circumstances."¹⁸³

Foreign investors are also required by law to establish a branch, subsidiary, or representative entity in China.¹⁸⁴ If a foreign company does not currently have any Chinese offices and is unfamiliar with the country, the best approach would be to set up a representative office first.¹⁸⁵ Representative offices in China are regulated by national and local regulatory regimes.¹⁸⁶ Representative offices are easy to set up, require minimal investment, and provide foreign investors with invaluable insight into local business practices and customs.¹⁸⁷ The downside is that they cannot conduct direct business activities, sign contracts, or own property.¹⁸⁸ However, a representative office can still make business contacts and render services on behalf of its head office.¹⁸⁹ Despite some limitations, setting up a representative office as a first step is still a well-advised decision for a foreign company newly venturing into the Chinese market.

The most common types of representative offices no longer require approval for establishment in China.¹⁹⁰ They may directly register with the relevant provincial industry and commerce authorities.¹⁹¹ The documents submitted must include a registration form, a letter of creditworthiness from the company's

183. See Xianchu Zhang & Philip Smart, *Development of Regional Conflict of Laws: On the Arrangement of Mutual Recognition and Enforcement of Judgments in Civil and Commercial Matters Between Mainland China and Hong Kong SAR*, 36 HONG KONG L.J. 554, 582-83 (2006) (describing the uncertainty caused by ambiguous definitions of "social public interest" in Chinese courts in the context of cross-border cooperation with Hong Kong).

184. Exploitation of Offshore Petroleum Resources in Cooperation with Foreign Parties Regulations, art. 15; Exploitation of Onshore Petroleum Resources in Cooperation with Foreign Parties Regulations, art. 17.

185. See DEAN ET AL., *supra* note 66, at 106-07 ("[T]he form that entails the least investment and the lowest legal profile is the representative office.").

186. *Id.* at 107.

187. *Id.* at 106-07.

188. *Id.* at 107.

189. *Id.*

190. *Id.*

191. *Id.*

bank, registration forms for all individual representatives doing business on behalf of the entity, and copies of the company's incorporation certificate and business registration certificate from the jurisdiction where the company is incorporated.¹⁹² The company must also register the representative office and its staff with the local tax bureau and several other governmental entities including the public security bureau and the local customs authority.¹⁹³

F. Dispute Resolution

If a dispute occurs between the foreign companies and the Chinese companies, it should be resolved through amicable negotiations.¹⁹⁴ If it cannot be resolved through negotiation, the parties may move onto mediation or arbitration.¹⁹⁵

Arbitration may be conducted by a Chinese arbitral body or the parties to the contract may agree on a different arbitral body.¹⁹⁶ This is one of the most important provisions when drafting a production sharing agreement: the dispute resolution clause.¹⁹⁷ Unlike litigation, arbitration is not associated with any one particular country and, therefore, eliminates any home court advantage a party may have.¹⁹⁸ Parties to a production sharing agreement can agree to have an international arbitral institution settle the disagreement.¹⁹⁹ Other than choosing which organization will handle the dispute – an important decision due to the various procedural rules each organization uses to govern the arbitral process – a dispute resolution clause should also

192. *Id.*

193. *Id.*

194. Duiwaihezuo Kaicai Haiyang Shiyou Ziyuan Tiaoli (对外合作开采海洋石油资源条例) [Exploitation of Offshore Petroleum Resources in Cooperation with Foreign Parties Regulations], art. 24.

195. *Id.*

196. *Id.*

197. See DEAN ET AL., *supra* note 66, at 303-04 (discussing the increasing reliance on arbitration by the international community and the value dispute resolution clauses give practicing attorneys).

198. *Id.* at 303.

199. *Id.* at 304-05.

include a choice of law provision, although most host governments will insist that their own country's laws govern any dispute.²⁰⁰

Arbitral awards are easier to enforce because they are governed by a treaty, the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.²⁰¹ Nearly every country in the world is party to this treaty, including China.²⁰² Therefore, China is obligated to respect agreements to arbitrate and to enforce any arbitral award covered by the New York Convention.²⁰³

Arbitrations seated in China, unlike other more arbitration-friendly jurisdictions, are subject to review by local courts, which have wide-ranging jurisdiction.²⁰⁴ For example, Chinese law generally prohibits administration by foreign arbitral institutions, such as the International Chamber of Commerce (ICC) or Hong Kong International Arbitration Centre (HKIAC), in China-seated arbitrations.²⁰⁵ Ad hoc arbitrations seated in China also go unrecognized in terms of enforceability by

200. *See id.* at 303 (noting the unwillingness of sovereign states to submit to foreign laws).

201. United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 3; DEAN ET AL., *supra* note 66, at 304.

202. DEAN ET AL., *supra* note 66, at 304; United Nations Comm'n on Int'l Trade Law, *Status: Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention_status.html (last visited Nov. 8, 2015); *see Contracting States – List of Contracting States*, N. Y. ARBITRATION CONVENTION, <http://www.newyorkconvention.org/list+of+contracting+states> (last visited Feb. 27, 2016) (listing the signatories to the Convention, along with their respective ratification dates).

203. United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, art. II, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 3; DEAN ET AL., *supra* note 66, at 304.

204. David Howell et al., *Chinese Arbitration – Still Distinctive*, 3 HARV. BUS. L. REV. ONLINE 196, 197 (2013), http://www.hblr.org/wp-content/uploads/2013/04/Howell-et-al._Chinese-Arbitration.pdf.

205. Shewai Minshi Guanxi Falu Shiyong Fa (涉外民事关系法律适用法) [Laws Applicable to Foreign-Related Civil Relations], (promulgated by Standing Comm. Nat'l People's Cong., Apr. 1, 2011), arts. 4-5; Howell et al., *supra* note 204, at 199; *see also* Tietie Zhang, *Enforceability of Ad Hoc Arbitration Agreements in China: China's Incomplete Ad Hoc Arbitration System*, 46 CORNELL INT'L L.J. 361, 377-78 (2013) (discussing instances when Chinese courts rejected ICC as an institution for China-seated arbitrations).

a foreign party.²⁰⁶ In addition, applications for interim relief are not dealt with by the arbitrators, as is the case in other jurisdictions, but by the Chinese courts.²⁰⁷

Parties are advised to negotiate modifications to their arbitration clauses.²⁰⁸ Foreign parties have historically preferred to seat their arbitrations in neutral venues such as Hong Kong and Singapore, which results in the award being treated as a foreign award for purposes of enforcement in China and is subject to a stronger, more effective enforcement mechanism than domestic awards.²⁰⁹ China has implemented a special procedure for enforcing foreign arbitral awards under the New York Convention.²¹⁰ It requires the Supreme People's Court to approve any decision by a lower court not to enforce a foreign award under the New York Convention.²¹¹

Foreign parties should also keep in mind that locally-incorporated subsidiaries of foreign companies may have to arbitrate in mainland China since they will be considered domestic parties under Chinese law.²¹² Chinese law stipulates that only "foreign related" arbitrations may be seated outside of China.²¹³ To qualify as a foreign related dispute, the dispute must involve at least one foreign party, the subject matter in dispute must be in a foreign country, or there are facts establishing the

206. Zhongcai Fa (仲裁法) [Arbitration Law], (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 31, 1994, effective Sept. 1, 1995), arts. 16, 18; see Zhang, *supra* note 183, at 367 (concluding that Chinese law prohibits ad hoc arbitrations).

207. See Howell et al., *supra* note 204, at 197 (explaining that interim measures are also limited in their scope to only two categories: preservation of property and preservation of evidence).

208. *Id.* at 198.

209. *Id.*

210. See Zuigao renmin fayuan guanyu renmin fayuan chuli yu shewai zhongcai ji waiguo zhongcai shixiang youguan wenti de tongzhi (最高人民法院关于人民法院处理与涉外仲裁及外国仲裁事项有关问题的通知) [1995 SPC Arbitration Enforcement Notice], (promulgated by the Supreme People's Court, Aug. 28, 1995), art. 1; Howell et al., *supra* note 204, at 198.

211. See Howell et al., *supra* note 204, at 198 (mandating that the Supreme People's Court review lower court opinions that involve a foreign arbitration).

212. *Id.*

213. *Id.*

legal relationship between the parties that occurred in a foreign country.²¹⁴

Even if there is an agreement to arbitrate, parties may still disagree as to whether an arbitration agreement covers their dispute.²¹⁵ Therefore, it is prudent to utilize a broad form arbitration provision. Narrow clauses are likely to invite disputes over the scope of the arbitration agreement and may even lead to piecemeal litigation.²¹⁶ If the parties fail to arbitrate and litigation ensues, Chinese regulations dictate that disputes fall under the jurisdiction of the Chinese civil court system.²¹⁷ To avoid litigating in Chinese courts, foreign enterprises should take care in drafting their dispute resolution clause before ventures begin.

G. A Brief Discussion of Taxes and Fees

The tax system for oil and gas enterprises in China is different from that of other industries.²¹⁸ There are five major types of taxes and fees: prospecting and mining rights fees, royalties, mineral resources compensation, resources tax, and special petroleum proceeds.²¹⁹

The price of prospecting and mining rights is based on assessments and is set by the State Council.²²⁰ The mineral

214. *Id.* at 198 n.7.

215. See DEAN ET AL., *supra* note 66, at 294-95 (describing a situation where the arbitration was controversial, due to a conflict of law problem between Russia and the United States).

216. See Howell, *supra* note 204, at 198 (describing some of the information that should be put into arbitration clauses such as providing a modification for the English language and having the arbitration administered by a tribunal of experienced international arbitrators).

217. Minshi Susongfa (民事诉讼法) [Civil Procedure Law] (promulgated by the Standing Comm. Nat'l People's Cong., Apr. 9, 1991, effective Apr. 9, 1991).

218. See *Overview of PRC Taxation System*, PWC NETWORK, http://www.pwchk.com/home/eng/prctax_corp_overview_taxation.html (last visited Oct. 16, 2015) (describing the natural resources tax in China, which is set on a volume basis determined by the Ministry of Finance).

219. See *id.* (showing the natural resources in China to which these taxes apply).

220. Tankuangquan Caikuangquan Shiyongfei He Jiakuan Guanli Banfa (探矿权采矿权使用费和价款管理办法) [Measures for Administration of Royalties and Price of Mineral Exploration Rights and Mining Rights] (promulgated by the Ministry of Finance, June 7, 1999, effective June 7, 1999), art. 8.

exploration right purchase price may be paid in a lump sum or in installments.²²¹ Prospecting price is paid for a maximum of two years, whereas mining right price is paid for a maximum of six years.²²²

Payment of royalties are paid in kind based on production.²²³ The royalty rates for offshore oil production are 0%-12.5% and 0%-3% for offshore gas.²²⁴ The royalty rates for onshore crude oil production also range from 0%-12.5%, whereas the royalty rates for onshore natural gas production are also 0%-12.5%.²²⁵ In 2011, the law was amended so that enterprises in Sino-foreign cooperation ventures shall pay taxes but no longer pay royalties.²²⁶ However, for contracts entered into before 2011, enterprises shall continue to pay royalties in accordance with the law at the time.²²⁷

The main difference between a royalty and a mineral resources compensation fee is that a royalty is based on annual production of crude oil and natural gas, whereas a mineral resources compensation fee is based on the sales income of mineral products.²²⁸ Since the introduction of this fee, the amount of taxes collected continue to grow, from 5 billion RMB in 2006 to

221. *Id.*

222. *Id.*

223. *See infra* text accompanying notes 224-25 (giving the exact royalty rates for offshore and onshore oil production).

224. Kaicai Haiyang Shiyou Ziyuan Jiaona Kuangqu Shiyongfeide Guiding (开采海洋石油资源缴纳矿区使用费的规定) [Provisions Concerning the Payment of Royalties for the Exploitation of Offshore Petroleum Resources] (promulgated by the Ministry of Finance, Jan. 1, 1989, effective Jan. 1, 1989).

225. Zhongwai Hezuo Kaicai Lushang Shiyou Ziyuan Jiaona Kuangqu Shiyongfei Zanxing Guiding (中外合作开采陆上石油资源缴纳矿区使用费暂行规定) [Provisions Concerning the Payment of Royalties for the Exploitation of Sino-foreign Onshore Petroleum Resources] (promulgated by the Ministry of Finance, July 28, 1995, effective July 28, 1995), art. 3.

226. *Id.* art. 11.

227. *Id.*

228. *Compare* Kuangchan Ziyuan Buchangfei Zhengshou Guanli Guiding (矿产资源补偿费征收管理规定) [Provisions on the Administration of Collection of the Mineral Resources Compensation] (promulgated by the State Council, July 3, 1997, effective July 3, 1997), art. 3 *with* Zhongwai Hezuo Kaicai Lushang Shiyou Ziyuan Jiaona Kuangqu Shiyongfei Zanxing Guiding (中外合作开采陆上石油资源缴纳矿区使用费暂行规定) [Provisions Concerning the Payment of Royalties for the Exploitation of Sino-foreign Onshore Petroleum Resources], art. 3.

10 billion RMB in 2008 to 20 billion RMB in 2013.²²⁹ In 2013, the mineral resources compensation fee from oil accounted for 35% of the total amount collected.²³⁰ Foreign operators are exempt to encourage investment.²³¹ However, the Chinese government has announced that starting December 1, 2014, the mineral resources compensation fee will be abolished.²³² The elimination of this source of revenue will be offset by an increase in the resources tax.²³³

The resources tax refers to the tax based on a variety of taxable natural resources. Only three items are taxable: oil, natural gas, and coal.²³⁴ In 1994, to expand the scope of tax adjustments, the tax was changed from being based on production volume to being based on selling price or value.²³⁵ In October 2014, the upstream resources tax on crude oil and natural gas was increased from 5% to 6%.²³⁶

Special petroleum proceeds refer to proceeds collected by the state on a certain proportion of the excessive returns obtained by petroleum projects from their sales of domestic crude oil when the price exceeds a certain level.²³⁷ The ratio for the collection of these proceeds are determined on the basis of the monthly weighted

229. *Woguo Kuangchan Ziyuan Buchangfei Zhengguan 20 Nian Huimou (我国矿产资源补偿费征缴20年回眸) [20 Years of China's Mineral Resources Compensation Collection Review]*, CHINESE LAND AND RESOURCES NEWS [中国国土资源新闻], (Apr. 29, 2014), <http://www.fjgtzy.gov.cn/cms/html/fjsgtzyt/2014-04-29/150387875.html> (translated by author).

230. *Id.*

231. Song Yen Ling, *China to Raise Oil, Gas Upstream Resource Tax to 6% from 5% Starting Dec 1*, PLATTS (Oct. 13, 2014, 7:46 AM), PLATTS, <http://www.platts.com/latest-news/natural-gas/singapore/china-to-raise-oil-gas-upstream-resource-tax-26901874>.

232. *Id.*

233. *Id.*

234. *Ziyuanshui Tiaoli (资源税条例) [Resource Tax Regulations]* (promulgated by the State Council, Dec. 25, 1993, effective Jan. 1, 1994), art. 3.

235. *Ziyuanshui Zanxing Tiaoli (资源税暂行条例) [Provisional Regulations on Resource Tax]* (promulgated by the State Council, Dec. 13, 1993, effective Jan. 1, 1994); Ling, *supra* note 231.

236. Ling, *supra* note 231.

237. *Notice of the Ministry of Finance on Printing and Distributing the Measures for the Administration of the Collection of Special Petroleum Proceeds*, GLOBAL LAW, <http://policy.mofcom.gov.cn/english/claw!fetch.action?id=e04859> (last visited Mar. 4, 2015).

average price of the crude oil sold.²³⁸ In 2015, the special petroleum proceeds was increased to \$65 per barrel²³⁹ and will be incorporated into the costs and expenses of the enterprise.²⁴⁰

In addition to the taxes and fees above, foreign enterprises investing in Chinese oil may also have to pay a corporate income tax, value-added tax, consumption tax, and business tax.²⁴¹ In 2015, the Ministry of Finance announced an increase in the consumption tax of oil products.²⁴² A foreign entity operating in China should pay close attention to each of these taxes and how they might affect the company's revenue.

H. Guarding Against Corruption

Another major concern for foreign companies operating in China is the issue of corruption. In 2014, Transparency International ranked China 100 out of 174 countries on the Corruption Perceptions Index.²⁴³ It was ranked at 80 in 2013 and 2012.²⁴⁴ This slip on the index was in spite of a very highly-publicized anti-corruption campaign begun by President

238. *Id.*

239. Guanyu Tigao Shiyou Tebie Shouyijin Qizhengdian de Tongzhi (关于提高石油特别收益金起征点的通知) [Notice of Increase of Special Petroleum Proceeds] (Dec. 25, 2014), http://szs.mof.gov.cn/zhengwuxinxi/zhengcefabu/201412/t20141226_1172974.html.

240. See *Notice of the Ministry of Finance on Printing and Distributing the Measures for the Administration of the Collection of Special Petroleum Proceeds*, *supra* note 237 (stating that as a result, the enterprise's income tax can be deducted).

241. DELOITTE, *TAXATION AND INVESTMENT IN CHINA 2015*, at 10, (2015), <http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-chinaguide-2015.pdf>.

242. See *China Announces Consumption Tax Increase on Oil Products*, OUT-LAW.COM (Jan. 14, 2015), <http://www.out-law.com/en/articles/2015/january/china-announces-consumption-tax-increase-on-oil-products/> (stating that the tax was raised to support counter-pollution initiatives and the new energy sector).

243. TRANSPARENCY INTERNATIONAL, *Corruption Perceptions Index 2014: Results*, <http://www.transparency.org/cpi2014/results> (last visited Feb. 12, 2015).

244. TRANSPARENCY INTERNATIONAL, *Corruption Perceptions Index 2013: Results*, <http://www.transparency.org/cpi2013/results> (last visited Feb. 12, 2015); TRANSPARENCY INTERNATIONAL, *Corruption Perceptions Index 2012: Results*, <http://www.transparency.org/cpi2012/results> (last visited Feb. 12, 2015).

Xi Jinping shortly after he took office in 2012.²⁴⁵ It has become a top concern for multinational companies doing business in China as the regulatory landscape changes.²⁴⁶ For example, a company that relies heavily on third party distributors will be more vulnerable to bribery and corruption.²⁴⁷

To prevent multinational companies from engaging in foreign corrupt practices, the U.S. Congress enacted the Foreign Corrupt Practices Act (FCPA) in 1977.²⁴⁸ Under the FCPA, it is unlawful for any publically-traded U.S. or foreign corporation to make payments to foreign government officials to obtain or retain business.²⁴⁹

The Justice Department has published a guide to the FCPA that explains its requirements in layman's terms.²⁵⁰ For starters, it is the U.S. company's responsibility to exercise due diligence and to take necessary precautions in selecting a reputable partner.²⁵¹ Due diligence may include investigating potential foreign representatives and joint venture partners to determine if they are qualified for the position, whether they have personal or professional ties to the government, the number and reputation of their clientele, and their reputation within the U.S. Embassy or Consulate and with local bankers, clients, and other business associates.²⁵²

245. Euan McKirdy, *China Slips Down Corruption Perception Index, Despite High-Profile Crackdown*, CNN (Dec. 3, 2014, 3:55 AM), <http://www.cnn.com/2014/12/03/world/asia/china-transparency-international-corruption-2014>.

246. Kent D. Kedl, *Behind China's Corruption Crackdown: Whistleblowers*, FORBES (Feb. 12, 2015, 11:37 AM), <http://www.forbes.com/sites/riskmap/2015/02/12/behind-chinas-corruption-crackdown-whistleblowers>.

247. *Id.*

248. Foreign Corrupt Practices Act of 1977 increased the enforcement for bribery of foreign officials. *See* Pub. L. No. 95-213, Stat. 1494.

249. Foreign Corrupt Practices Act, 15 U.S.C. § 78dd-1 (2014).

250. CRIMINAL DIV. OF THE U.S. DEP'T OF JUSTICE & ENF'T DIV. OF THE U.S. SEC. & EXCHANGE COMM'N, A RESOURCE GUIDE TO THE U.S. FOREIGN CORRUPT PRACTICES ACT (2012), <http://www.justice.gov/criminal/fraud/fcpa/guidance/guide.pdf>.

251. *See id.* at 60 (describing some of the resources provided by the Department of Commerce for businesses to do proper due diligence).

252. *Id.* at 59.

The guide also discusses certain “red flags” that corporations should be aware of when doing business in foreign countries.²⁵³ The red flags include unusual payment patterns or financial arrangements, a history of corruption in the country, a refusal by the foreign joint venture partner or representative to provide a certification that it will not take any action in furtherance of an unlawful offer, promise, or payment to a foreign public official and not take any act that would cause the U.S. company to be in violation of the FCPA, unusually high commissions, lack of transparency in expenses and accounting records, apparent lack of qualifications or resources on the part of the joint venture partner or representative to perform the services offered, and whether the joint venture partner or representative has been recommended by an official of the potential governmental customer.²⁵⁴

China’s Criminal Law also criminalizes bribery of government officials and officials of international public organizations.²⁵⁵ However, China has a custom of building connections and relationships by giving gifts or small favors, which might be considered bribery by foreign companies and international anti-corruption legislation.²⁵⁶ Companies should give careful consideration to the type and value of the gifts and the nature of the business relations.²⁵⁷

IV. CONCLUSION

After thirty years of development, the Chinese oil industry has evolved greatly. However, compared to many western countries, China’s oil industry is still very monopolistic.²⁵⁸

253. *Id.* at 22-23

254. *Id.*

255. *Zhongguo Xingfa* (中国刑法) [Criminal Law of the People’s Republic of China] (promulgated by the Standing Comm. Nat’l People’s Cong., July 1, 1979, effective July 1, 1979).

256. *Business Corruption in China*, BUS. ANTI-CORRUPTION PORTAL (Oct. 2015), <http://www.business-anti-corruption.com/country-profiles/east-asia-the-pacific/china/snapshot.aspx>.

257. *Id.*

258. See *Youqi Xingzheng Longduan Shi Dianxing Tizhi Cuopei Zhili Renzhong Daoyuan* (油气政整断是典型体制错配 治理任重道远), ECONOMIC OBSERVER (Feb. 15, 2015,

Administrative monopoly power also extends to other areas, such as transportation, sales, and even imports.²⁵⁹ After years of effort, China has developed a number of laws, regulations, and amendments for the oil industry. However, there are still many gaps and a complete system has not been formed. In the absence of legal clarity, Chinese management often relies on industry sector regulations. This opens the door to internal deals and corruption.

Oil monopoly leads to many problems in the industry, such as low productivity, frequent shortages of oil, high oil prices, and lack of international competitiveness, among other things.²⁶⁰ The Chinese government recognizes that monopoly by the big three Chinese oil companies hinders competition and creates an unequal position between market competitors.²⁶¹ It also affects the cultivation of independent economic entities.²⁶²

Resource nationalism is another growing concern. Resource nationalism is a government's effort to obtain more control over their natural resources, often to the detriment of private companies.²⁶³ This may happen in the form of outright expropriation – when the government takes away a company's assets – or creeping expropriation – where the government raises taxes or fees so high that it becomes unprofitable for the company to continue operations.²⁶⁴ The difficulty is finding the line between resource nationalism and legitimate national interest.²⁶⁵ This issue is usually strongly linked to a country's political environment.²⁶⁶ Although China's current political climate is

8:46 AM), <http://money.163.com/15/0215/08/AIFVISOA00252G50.html> (translated by author) (describing the monopolistic characteristics of China's oil and gas industry).

259. *Id.*

260. *See id.* (stating these effects as well as other monopoly issues).

261. *See* LI KEQIANG, REPORT ON THE WORK OF THE GOVERNMENT 15-16 (2014), http://online.wsj.com/public/resources/documents/2014GovtWorkReport_Eng.pdf (focusing on accelerating the development of a mixed-ownership economy).

262. *Id.*

263. Jessica Morris, *Why Resource Nationalism Could Be Increasing*, CNBC (Feb. 7, 2014, 9:46 AM), <http://www.cnbc.com/id/101399000#>.

264. *Id.*

265. *See id.* (“It gets tricky when governments are after legitimate concerns, but do so in a clumsy way.”).

266. *Id.*

stable, the autocratic nature of its government lends an uncertain air to its future political and legal leanings.²⁶⁷

As China's population grows and the standard of living rises, its oil demand will only continue to soar.²⁶⁸ In order to prosper into the future, China needs foreign investment and foreign technology to develop its petroleum resources. However, foreign companies are not feeling as welcome in China as before.²⁶⁹

Many obstacles encumber a foreign company's investments in the Chinese petroleum market, including environmental concerns, government crackdowns, resource nationalism, conflicting laws, and legislative loopholes. China's petroleum laws should allow international oil companies more flexibility. Foreign enterprises should have more room to negotiate their terms. Laws and regulations require more legal clarity. Governmental regulation should be reduced. Only through mutual cooperation and a transparent legal framework will all parties benefit from international collaboration.

267. See Fred Bergsten et al., *China's Rise: Challenges and Opportunities*, Sept. 2008, at 32 (describing some problems with China's autocratic government).

268. *Energy Consumption: The Asian Experience*, ENVTL. JOURNALISM IN ASIA-PACIFIC, <http://ejap.org/environmental-issues-in-asia/energy-consumption.html> (last visited Oct. 17, 2015).

269. See Calum MacLeod, *Foreign Firms in China Gripe About Internet, Pollution*, USA TODAY (Feb. 12, 2015, 12:12 PM), <http://www.usatoday.com/story/money/2015/02/12/china-internet-curbs-hurt-us-business/23283491> (describing a way China is discouraging foreign business and investment).