

Corporate Governance Report

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GOVERNANCE STANDARDS

The Company has always upheld and executed high standard of business ethics, for which its transparency and standard of governance have been recognized by the public and its shareholders. High and strict standard of corporate governance enables the Company to operate steadily and efficiently and is in the long-term interests of the Company and its shareholders.

Since its listing, the Company has endeavoured to maximize its shareholders' value. In 2005, the Company executed its corporate governance policies strictly and sought to comply with relevant provisions of the Code on Corporate Governance Practices (the "CG Code") as set out in Appendix 14 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules"), ensuring that all decisions were made on principles of trust and fairness and in an open and transparent manner, so as to protect the interests of all shareholders.

KEY CORPORATE GOVERNANCE PRINCIPLES AND THE COMPANY'S PRACTICES

A. DIRECTORS

A.1 The Board

Principle: "An issuer should be headed by an effective board which should assume responsibility for leadership and control of the issuer and be collectively responsible for promoting the success of the issuer by directing and supervising the issuer's affairs. Directors should take decisions objectively in the interests of the issuer."

- The Board consists of twelve members. Five of them are Independent Non-executive Directors.
- The list of Directors, their respective biographies, and their respective roles in the Board committees are set out on pages 52 to 56 and 163 respectively. The relevant information is also disclosed in the Company's website.
- The Board and committee members of the Company are dedicated, professional and accountable. With internationally recognised figures serving on the international advisory board, the Company's corporate governance standards are further enhanced.

- Board meetings have been held 17 times during last year. In addition to the Board meetings, the members of the Board have also actively participated in the discussion on the business and operation of the Company, either in person or through other electronic means of communication such as email, when necessary.
- There exists an open atmosphere for Directors to contribute alternative views. All decisions of the Board are made on the principles of trust and fairness in an open and transparent manner, so as to protect the interests of all shareholders.

Attendance at full Board meetings in 2005

| | No. of Meetings attended (17 meetings in total) |
|--|--|
| Executive Directors | |
| Fu Chengyu | 17/17 |
| Luo Han | 14/17 |
| Zhou Shouwei | 17/17 |
| Cao Xinghe (Note 3) | 3/3 |
| Wu Zhenfang (Note 3) | 2/3 |
| Wu Guangqi (Note 1) | 14/15 |
| Yang Hua (Note 3) | 2/3 |
| Independent Non-executive Directors | |
| Chiu Sung Hong | 17/17 |
| Kenneth S. Courtis | 14/17 |
| Evert Henkes | 16/17 |
| Tse Hau Yin, Aloysius (Note 2) | 14/14 |
| Lawrence J. Lau (Note 4) | 3/3 |

Note 1: Mr. Wu Guangqi was appointed as Executive Director with effect from 1 June 2005.

Note 2: Mr. Tse Hau Yin, Aloysius was appointed as Independent Non-executive Director with effect from 8 June 2005.

Note 3: Mr. Cao Xinghe, Mr. Wu Zhenfang and Mr. Yang Hua were appointed as Executive Directors with effect from 31 August 2005.

Note 4: Professor Lawrence J. Lau was appointed as Independent Non-executive Director with effect from 31 August 2005.

- The Company Secretary consulted the Directors on matters to be included in the agenda for regular Board meetings.
- Dates of regular Board meetings are scheduled at least 2 months ahead to provide sufficient notice to give all Directors an opportunity to attend. For non-regular Board meetings, reasonable notice will be given.
- Directors have access to the advice and services of the Company Secretary to ensure that Board procedures as well as all applicable rules and regulations are followed.
- Minutes of meetings of the Board and Board committees are kept by the Company Secretary and open for inspection at any reasonable time on reasonable notice by any Director.
- Minutes of meetings of the Board and Board committees recorded sufficient details the matters considered by the Board and Board committees and decisions reached, including any concerns raised by Directors or dissenting views expressed. Draft and final versions of minutes of Board meetings and Board committee meetings are sent to all Directors and all committee members respectively for their comments and records respectively.
- The committees of the Board are able, upon reasonable request, to seek independent professional advice in appropriate circumstances, at the Company's expense.
- If a substantial shareholder or a Director has conflict of interest in a matter to be considered by the Board which the Board has determined to be material, the matter shall not be dealt with by way of circulation or by a committee (except an appropriate Board committee set up for that purpose pursuant to a resolution passed in a Board meeting) but a Board meeting shall be held. Independent Non-executive Directors who have no material interest in the transaction shall be present at such Board meeting.

A.2 Chairman and Chief Executive Officer

Principle: "There are two key aspects of the management of every issuer - the management of the board and the day-to-day management of the issuer's business. There should be a clear division of these responsibilities at the board level to ensure a balance of power and authority, so that power is not concentrated in any one individual."

- The Board, as representatives of the shareholders of the Company, is committed to the achievement of business success and the enhancement of long-term shareholder value with the highest standards of integrity and ethics. The Board comprises five Independent Non-executive Directors who participate in the decision-making of the Board. Besides, the Audit Committee and the Remuneration Committee comprise solely Independent Non-executive Directors. The Company believes that the high involvement of the Independent Non-executive Directors in the management and decision making of the Board and its committees strengthens the objectivity and independence of the Board.
- The role of the Board is to direct, guide and oversee the conduct of the Company's business and to ensure that the interests of the shareholders are being served.
- On the other hand, the senior management, under the direction of the Chief Executive Officer, is responsible for conducting the Company's business and affairs consistent with the principles and directions established by the Board. The clear division of responsibilities between the Board and the senior management ensures a balance of power and authority, as well as efficient management and operation of the Company, which help to contribute to the success of the Company.

- The Company did not divide the roles of the Chairman and the Chief Executive Officer. The Board believes that this structure contributes to a strong and efficient leadership which is beneficial to the development of the Company. It also enables the Company to make and implement decisions promptly and efficiently. On the other hand, the balance of power and authority is ensured by the operations of the Board and the Board committees. Further explanation on the deviation from the Code Provision is set out on page 38.

A.3 Board composition

Principle: "The board should have a balance of skills and experience appropriate for the requirements of the business of the issuer. The board should ensure that changes to its composition can be managed without undue disruption. The board should include a balanced composition of executive and non-executive directors (including independent non-executive directors) so that there is a strong independent element on the board, which can effectively exercise independent judgement. Non-executive directors should be of sufficient calibre and number for their views to carry weight."

- The Board consists of twelve members. Five of them are Independent Non-executive Directors. All Directors are expressly identified by categories of Executive Directors and Independent Non-executive Directors in all corporate communications that disclose the names of Directors of the Company.
- The Executive Directors of the Company are all individuals with immense experience in the Company's respective fields of operation. They are all engineers who are familiar with the Company's business and have been exposed to dealing with leading global players in the oil and gas industry. Most of them have over 25 years of experience in petroleum exploration and operation.

- The five Independent Non-executive Directors of the Company are all professionals or scholars with backgrounds in the legal, economics, financial and investment fields. They have extensive experience and knowledge of corporate management, making significant contributions to the Company's strategic decisions.
- The appointment of Mr. Tse Hau Yin, Aloysius and Professor Lawrence J. Lau as Independent Non-executive Directors in 2005 strengthened the independence and broadened the expertise of the Board.
- The diverse background of the Board members ensures that they can fully represent the interests of all shareholders of the Company.
- The Company has received annual confirmations from all its Independent Non-executive Directors acknowledging full compliance with the relevant requirements in respect of their independence pursuant to Rule 3.13 of the Listing Rules. The Company therefore considers all Independent Non-executive Directors independent.

A.4 Appointments, re-election and removal

Principle: "There should be a formal, considered and transparent procedure for the appointment of new directors to the board. There should be plans in place for orderly succession for appointments to the board. All directors should be subject to re-election at regular intervals. An issuer must explain the reasons for the resignation or removal of any director."

- The Company has established a Nomination Committee which consists of an Executive Director and three Independent Non-Executive Directors. A list of members of the Nomination Committee is set out under the section headed "Company Information" on page 163 of the annual report.

- The role of the Nomination Committee is to establish proper procedures for the selection of the Company's leadership positions, upgrade the quality of Board members and perfect the Company's corporate governance structure.
- The main authorities and responsibilities of the Nomination Committee are to nominate candidates for approval by the Board, to review the structure and composition of the Board, and to evaluate the leadership abilities of Executive and Non-executive Directors, so as to ensure the competitive position of the Company.
- When nominating a particular candidate, the Nomination Committee will consider (1) the breadth and depth of management and/or leadership experience of the candidate; (2) financial literacy or other professional or business experience of the candidate that are relevant to the Company and its business; and (3) the experience in or knowledge of international operations of the candidate. All candidates must be able to meet the standards set out in Rules 3.08 and 3.09 of the Listing Rules.
- The Nomination Committee is also responsible for evaluating the contributions and independence of incumbent Directors so as to determine whether they should be recommended for re-election. Based on such evaluation, the Nomination Committee will recommend to the Board candidates for re-election at general meetings and appropriate replacements (as necessary). The Board, based on the recommendation of the Nomination Committee, will propose to the shareholders the candidates for re-election at the relevant general meetings.
- A Director appointed by the Board to fill a casual vacancy or as an addition shall hold office until the next extraordinary general meeting and/or annual general meeting (as appropriate).
- During the year ended 31 December 2005, the Nomination Committee recommended the following candidates as Directors:

- (a) the appointment of Mr. Wu Guangqi as Executive Director with effect from 1 June 2005 to replace Mr. Jiang Longsheng, who ceased to be an Executive Director with effect from 1 June 2005;
- (b) the appointment of Mr. Tse Hau Yin, Aloysius with effect from 8 June 2005 to replace Dr. Erwin Schurtenburger, who ceased to be an Independent Non-executive Director with effect from 1 April 2005; and
- (c) the appointment of Mr. Cao Xinghe, Mr. Wu Zhenfang and Mr. Yang Hua as Executive Directors, and Professor Lawrence J. Lau as Independent Non-executive Director with effect from 31 August 2005, to further strengthen the Board and cater for the needs of the expanding business of the Company.

**Attendance of individual members at
Nomination Committee meetings in 2005**

| | No. of Meetings attended (5 meetings in total) |
|--------------------------------|---|
| Directors | |
| Luo Han (Chairman) | 5/5 |
| Chiu Sung Hong | 5/5 |
| Tse Hau Yin, Aloysius (Note 1) | 1/1 |
| Lawrence J. Lau (Note 2) | 0/0 |

Note 1: Mr. Tse Hau Yin, Aloysius was appointed as a member of the Nomination Committee with effect from 31 August 2005.

Note 2: Professor Lawrence J. Lau was appointed as a member of the Nomination Committee with effect from 20 December 2005.

A.5 Responsibilities of directors

Principle: "Every director is required to keep abreast of his responsibilities as a director of an issuer and of the conduct, business activities and development of that issuer. Given the essential unitary nature of the board, non-executive directors have the same duties of care and skill and fiduciary duties as executive directors."

- The Company regularly updates its Directors with changes in laws and regulations relevant to their role as Director of the Company.
- All Directors newly appointed to the Board (whether as Executive or Non-executive Directors) receive appropriate briefing and training from the Company. The senior management and the Company Secretary will also conduct subsequent briefings as and when necessary, to ensure that the Directors are kept apprised of the latest developments relevant to the operations and business of the Company and are able to discharge their responsibilities properly.
- Each Independent Non-executive Director attended all regularly scheduled meetings of the Board and committees on which such Independent Non-executive Director sat in, and reviewed the meeting materials distributed in advance for such meetings. A number of Executive Directors, together with several Independent Non-executive Directors, attended the annual general meeting and the extraordinary general meetings and answered questions raised by the shareholders.

A.6 Supply of and access to information

Principle: "Directors should be provided in a timely manner with appropriate information in such form and of such quality as will enable them to make an informed decision and to discharge their duties and responsibilities as directors of an issuer."

- The Company's senior management regularly supplies the Board and its committees with adequate information in a timely manner to enable them to make informed decisions. Senior management also organised presentations to the Board by professional advisers on specific transactions as appropriate.

- For regular Board meetings and Board committee meetings, the agenda and accompanying Board papers were sent in full to all Directors at least three days before the intended date of the Board meetings or Board committee meetings.
- The Board and each Director have separate and independent access to the Company's senior management and also the Company Secretary. All Directors are entitled to have access to Board papers, minutes and related materials upon reasonable notice.

B. REMUNERATION OF DIRECTORS AND SENIOR MANAGEMENT

B.1 The level and make-up of remuneration and disclosure

Principle: "An issuer should disclose information relating to its directors' remuneration policy and other remuneration related matters. There should be a formal and transparent procedure for setting policy on executive directors' remuneration and for fixing the remuneration packages for all directors. Levels of remuneration should be sufficient to attract and retain the directors needed to run the company successfully, but companies should avoid paying more than is necessary for this purpose. No director should be involved in deciding his own remuneration."

- Comprising three Independent Non-executive Directors, the Remuneration Committee is responsible for reviewing and approving all Executive Directors' salaries, bonuses, share option packages, performance appraisal systems and retirement plans. A list of members of the Remuneration Committee is set out in "Company Information" on page 163.
- Details of the remuneration, as well as the share option benefits of Directors for the year ended 31 December 2005, are set out on pages 105 to 106.

- The major responsibilities and authorities of the Remuneration Committee are to make recommendations to the Board on the Company's policy and structure for all remuneration of Directors and the senior management, determine the specific remuneration packages for all Executive Directors and senior management, such as benefits in kind, pension rights and compensation payments, including any compensation payable for loss or termination of their office or appointment, and make recommendations to the Board on the remuneration of Independent Non-executive Directors.
- The Company's emolument policy is to maintain fair and competitive packages with reference to perception of industry standards and prevailing market conditions. The Remuneration Committee was mindful that levels of remunerations sufficient to attract and retain the Directors and senior management were needed to run the Company successfully, but at the same time avoid paying more than is necessary for this purpose. The Directors' emolument package comprises Director's fee, basic salaries and allowances, bonuses, share options and others. The following factors are considered when determining the Directors' remuneration package:
 - Business needs and company development;
 - Responsibilities of the Directors and individual contribution;
 - Changes in appropriate markets, e.g. supply/demand fluctuations and changes in competitive conditions; and
 - The desirability of performance-based remuneration.

No individual Director or senior management of the Company was permitted to determine his/her own remuneration.

The Company sought to apply similar principles when determining the remuneration packages for senior management and other general staff, and employees are rewarded on a performance-rated basis as well as other fringe benefits such as social insurance, pension fund and medical cover.

Please refer to note 12 and note 13 to the financial statements on page 105 to 107 for details of Directors' remuneration and the five highest paid individuals in the Company.

- The remuneration of Independent Non-executive Directors recommended by the Remuneration Committee was determined by the Board where the vote of the Directors concerned will not be counted in relation to their remuneration.
- The Remuneration Committee also administered the Company's share option schemes and all other employee equity-based compensation plans, with full authority to make all other determinations in the administration thereof, but subject to the limitations prescribed by laws and the rules of such plans and programs.
- The Remuneration Committee would consult the Chairman and Chief Executive Officer about its proposal relating to the remuneration of other Executive Directors and have access to professional advice if necessary.

Attendance of individual members at Remuneration Committee meetings in 2005

| Independent Non-executive Directors | No. of Meetings attended (5 meetings in total) |
|--|---|
| Chiu Sung Hong (Chairman) | 5/5 |
| Evert Henkes | 5/5 |
| Tse Hau Yin, Aloysius (Note) | 3/3 |

Note: Mr. Tse Hau Yin, Aloysius was appointed as a member of the Remuneration Committee with effect from 8 June 2005.

C. ACCOUNTABILITY AND AUDIT

C.1 Financial reporting

Principle: “The board should present a balanced, clear and comprehensible assessment of the company’s performance, position and prospects.”

- The Company regularly updates investors with progress of development and performance of the Company through formal channels such as annual report, interim report and announcements made through HKEx’s website and newspapers, as well as through press releases. The Company also issues quarterly operational statistics and announces its strategy at the beginning of the year to enhance transparency about its performance and to give details of the latest development of the Company in a timely manner.
- The Company provides a comprehensive business review in its interim and annual reports to enable investors to appraise its development over time and its financial position.
- The Company has also engaged an independent technical consultant firm to conduct a review of its oil and gas information and discloses details of its oil and gas properties in its annual report (as set out on pages 146 to 150).

C.2 Internal controls

Principle: “The board should ensure that the issuer maintains sound and effective internal controls to safeguard the shareholders’ investment and the issuer’s assets.”

- The Company has established internal control system and mechanism and will continue to improve such systems to comply with regulatory requirements and to enhance corporate governance of the Company.
- The Audit Committee of the Board is responsible for overseeing the operation of the internal monitoring systems, so as to ensure that the Board is able to monitor the Company’s overall financial position, to protect the Company’s assets, and to prevent major errors resulting from financial reporting or loss.

- The Audit Committee has reviewed, together with senior management and the external auditors, the accounting principles and practices adopted by the Group and discussed the internal control and financial reporting matters.

C.3 Audit Committee

Principle: “The board should establish formal and transparent arrangements for considering how it will apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the company’s auditors. The audit committee established by an issuer pursuant to the Exchange Listing Rules should have clear terms of reference.”

- The Audit Committee consists of three Independent Non-executive Directors, with Dr. Kenneth Courtis designated as the Audit Committee financial expert for the purposes of U.S. securities laws. A list of members of the Audit Committee is under the section headed “Company Information” on page 163 of the annual report.
- The Audit Committee meets at least twice a year and is responsible for reviewing the completeness, accuracy and fairness of the Company’s accounts, evaluating the Company’s auditing scope and procedures as well as its internal control systems.
- Full minutes of Audit Committee meetings are kept by the Company Secretary. Draft and final versions of minutes of the Audit Committee meetings are sent to all members of the Audit Committee for their comments and records respectively, in both cases within a reasonable time after the meetings.
- The Audit Committee is also responsible for overseeing the operation of the internal monitoring systems so as to ensure that the Board is able to monitor the Company’s overall financial position, to protect the Company’s assets, and to prevent major errors resulting from financial reporting or loss.

- The following is a summary of the work performed by the Audit Committee under its charter during the year:
 - Reviewed the Company's audited accounts and results announcement before it is tabled before the Board for approval, discussing with senior management and the external auditors;
 - The Audit Committee held formal meetings with the external auditors and senior management of the Company at least twice a year to discuss the following matters:
 - (i) the external auditor's engagement letter and general scope of their audit work, including planning and staffing of the audit;
 - (ii) the Company's management discussion and analysis disclosures in the interim report and annual report of the Company;
 - (iii) the applicable accounting standards relating to the audit of the Company's financial statements, including any recent changes;
 - In addition to formal meetings arrangement by the Company, members of the Audit Committee were also given direct access to the external auditors and have frequent contacts with the external auditors to discuss issues from time to time;
 - Conducted a review of the effectiveness of the system of internal controls of the Company and its subsidiaries, including financial, operational and compliance controls, as well as risk management aspects of internal controls, and made recommendation to the Board based on the review;
 - Discussing with senior management of the Company ways of improving and strengthening the scope, adequacy and effectiveness of the Company's internal controls, including corporate accounting and financial controls, both under the Listing Rules as well as under relevant US requirements;
 - Made recommendation to senior management and the Board on the scope and quality of management's ongoing monitoring of risks and issues relevant to internal controls;
 - Reviewed the work performed by the Company's external auditors and their relationship with the Company's senior management, and recommended to the Board for the re-appointment of Ernst & Young as external auditors, as well as the proposed auditor's fees;
 - Reviewed the Company's audit and non-audit services pre-approval policy to ensure auditor independence;
 - Members of the Audit Committee received materials from the Company's external auditors from time to time in order to keep abreast of changes in financial reporting principles and practices, as well as issues relating to financial reporting and internal controls relevant to the Company.
 - Considered and approved the non-audit services provided by the external auditors during the year;
 - Reviewed the Company's business ethics and compliance policies, related reports and training programs and making recommendation for improvement; and
 - Reported on its findings and suggestions to the Board following its review of different aspects of the Company's financial reporting and internal control systems, and made appropriate recommendations where necessary.
- The Audit Committee is provided with sufficient resources, including independent access to and advice from external auditors.

| Attendance of individual members at Audit Committee meetings in 2005 | |
|--|--|
| Independent Non-executive Directors | No. of Meeting attended (3 meetings in total) |
| Chiu Sung Hong (Chairman) | 3/3 |
| Kenneth S. Courtis | 3/3 |
| Tse Hau Yin, Aloysius (Note) | 2/2 |

Note: Mr. Tse Hau Yin, Aloysius was appointed as a member of the Audit Committee with effect from 8 June 2005.

D. DELEGATION BY THE BOARD

D.1 Management functions

Principle: "An issuer should have a formal schedule of matters specifically reserved to the board for its decision. The board should give clear directions to management as to the matters that must be approved by the board before decisions are made on behalf of the issuer."

- The Board is the ultimate decision-making body of the Company, other than those matters reserved to shareholders of the Company. The Board oversees and provides strategic guidance to senior management in order to enhance the long-term value of the Company for its shareholders.
- The day-to-day management is conducted by senior management and employees of the Company, under the direction of the Chief Executive Officer and the oversight of the Board. In addition to its general oversight of management, the Board also performs a number of specific functions.
- The primary functions performed by the Board include:
 - (i) reviewing and approving long-term strategic plans and annual operating plans, and monitoring the implementation and execution of those plans;

- (ii) reviewing and approving significant financial and business transactions and other major corporate actions; and
- (iii) reviewing and approving financial statements and reports, and overseeing the establishment and maintenance of controls, processes and procedures to ensure accuracy, integrity and clarity in financial and other disclosures.

D.2 Board committees

Principle: "Board committees should be formed with specific written terms of reference which deal clearly with the committees' authority and duties."

- The Company has formed an Audit Committee, a Remuneration Committee and a Nomination Committee of the Board, each committee with its own specific charter.

E. COMMUNICATION WITH SHAREHOLDERS

E.1 Effective communication

Principle: "The board should endeavour to maintain an on-going dialogue with shareholders and in particular, use annual general meetings or other general meetings to communicate with shareholders and encourage their participation."

- The Board recognises the importance of good and effective communication with all shareholders. With a policy of being transparent, strengthening investor relations, and providing consistent and stable returns to shareholders, the Company seeks to ensure transparency through establishing and maintaining different communication channels with shareholders.
- The Company has a professionally-run investor relations department to serve as an important communication channel between the Company and its shareholders and other investors. In 2005, the Company was selected by sell-side analysts as "the Best Investor Relations in Oil and Gas Industry" according to the *Institutional Investor* research group and was named No. 1 for Best Corporate Governance in China by *FinanceAsia* magazine.

- A key element of effective communication with shareholders and investors is prompt and timely dissemination of information in relation to the Company. In addition to announcing its interim and annual results to shareholders and investors, the Company also publicises its major business developments and activities through press releases, announcements and the Company's website in accordance with relevant rules and regulations. Press conferences and analyst briefings are held from time to time on financial performance and major transactions.
- The annual general meeting also provides a useful forum for shareholders to exchange views with the Board. The Chairman of the Board, as well as chairmen of the Audit Committee, Nomination Committee and Remuneration Committee, or in their absence, members of the respective committees, are available to answer questions from shareholders at annual general meetings and extraordinary general meetings of the Company.

E.2 Voting by Poll

Principle: "The issuer should regularly inform shareholders of the procedure for voting by poll and ensure compliance with the requirements about voting by poll contained in the Exchange Listing Rules and the constitutional documents of the issuer."

- Details of the poll voting procedures and the rights of shareholders to demand a poll are set out on page 63 of this annual report, and are included in circulars to shareholders despatched by the Company.
- The results of the poll are published in newspapers as well as on the Stock Exchange and the Company's website.
- The Company has also complied with the requirements concerning voting by poll under the Listing Rules. For example, voting was conducted by poll in respect of the connected transactions at the Company's recent extraordinary general meeting held on 31 December 2005.

COMPLIANCE WITH THE CODE ON CORPORATE GOVERNANCE PRACTICES

The Company has complied with the Code Provisions of the CG Code as set out in Appendix 14 of the Listing Rules throughout the year ended 31 December, 2005, except for deviations from Code Provisions A.2.1, A.4.1, A.4.2 and B.1.3 only. The following summaries the Company's deviations from the CG Code and the reasons for such deviations.

Code Provision A.2.1

Under Code Provision A.2.1, the roles of the chairman and chief executive officer are required to be separated and not to be performed by the same individual.

Mr. Fu Chengyu ("Mr. Fu") is the Chairman of the Board. In addition to the role of the Chairman, the role of Chief Executive Officer is also designated to Mr. Fu. This constitutes a deviation from Code Provision A.2.1. The reason for such deviation is set out below.

The Company is engaged in the oil and gas exploration and production business which is different from integrated oil companies engaging in both upstream and downstream operations. In light of this, the Board considers that the interest of the Company's oil and gas exploration and production business is best served when strategic planning decisions are made and implemented by the same person. The Company's Nomination Committee also agreed that it is in the best interest of the Company that the roles of the Chairman of the Board and Chief Executive Officer be performed by the same individual.

In light of the above, the Company does not currently propose to designate another person as the Chief Executive Officer of the Company.

Code Provision A.4.1

Under Code Provision A.4.1, non-executive directors should be appointed for a specific term and be subject to re-election.

None of the existing Independent Non-executive Directors of the Company is appointed for a specific term. This constitutes a deviation from Code Provision A.4.1. However, all the Directors of the Company (executive and non-executive) are subject to the retirement provisions under article 97 of the articles of association of the Company (“**Article 97**”). According to Article 97, one-third of the Directors for the time being must retire from the office by rotation at each annual general meeting. The Company has observed the need for good corporate governance practices and all the existing Independent Non-executive Directors of the Company have been re-elected in past three years, except Mr. Lawrence J. Lau, who was appointed as an Independent Non-executive Director of the Company with effect from 31 August 2005. Therefore, the Company considers that sufficient measures have been taken to ensure that the Company’s corporate governance practices are no less exacting than those in the CG Code.

Code Provision A.4.2

Under Code Provision A.4.2, every Director, including those appointed for a specific term, should be subject to retirement by rotation at least once every three years. Mr. Fu, the Chairman of the Company, was re-elected as a Director on 6 June 2002. Although he did not retire by rotation at the annual general meeting held on 25 May 2005 as under Article 97 a Director who is also a chairman or chief executive officer of the Company is exempted from the requirement to retire by rotation, he was re-elected as a Director at the extraordinary general meeting held on 31 December 2005 to comply with Code Provision A.4.2.

Code Provision B.1.3

Code Provision B.1.3 requires the terms of reference of the remuneration committee of the Company to include, as a minimum, certain specific duties set out in such Code Provision.

Previously, the Company’s Remuneration Committee charter did not mirror the exact wording of the terms of reference in Code Provision B.1.3. The Company has therefore revised its Remuneration Committee charter to comply with the provisions in Code Provision B.1.3.

CHANGES IN DIRECTORSHIP

On 1 April 2005, Mr. Erwin Schurtenberger resigned as an Independent Non-executive Director of the Company for personal reasons due to ill health. Mr. Tse Hau Yin, Aloysius (“Mr. Tse”) was subsequently appointed as an Independent Non-executive Director of the Company in place of Mr. Erwin Schurtenberger on 8 June 2005. Mr. Tse was also appointed as a member of the Audit Committee, Remuneration Committee and Nomination Committee of the Company.

Mr. Jiang Longsheng, an Executive Director of the Company, retired on 1 June 2005 and Mr. Wu Guangqi was appointed as an Executive Director of the Company in place of Mr. Jiang Longsheng with effect from the same day. Mr. Wu Guangqi was also appointed as the Compliance Officer of the Company.

Based on the recommendation of the Nomination Committee, Mr. Cao Xinghe, Mr. Wu Zhenfang and Mr. Yang Hua were appointed as Executive Directors of the Company, and Mr. Lawrence J. Lau was appointed as an Independent Non-executive Director of the Company, all with effect from 31 August 2005, to further strengthen the Board and cater for the needs of the expanding business of the Company.

During the period between Mr. Erwin Schurtenberger’s resignation and Mr. Tse’s appointment as an Independent Non-executive Director of the Company, the Audit Committee only comprised of two Independent Non-executive Directors and therefore the Company was not in strict compliance with Rule 3.21 of the Listing Rules, which requires an audit committee to comprise of at least three Independent Non-executive Directors. The Company had informed the Stock Exchange immediately and published an announcement in newspapers containing relevant details in compliance with Rule 3.23 of the Listing Rules. The Company had also, in accordance with Rule 3.23 of the Listing Rules, ensured that an appropriate member was appointed to the Audit Committee within three months of Mr. Erwin Schurtenberger’s resignation. After Mr. Tse’s appointment with effect from 8 June 2005 as an Independent Non-executive Director and a member of the Audit Committee of the Company, the Audit Committee comprised three Independent Non-executive Directors and the Company is in compliance with Rule 3.21 of the Listing Rules.

CODE OF ETHICS

The Board adopted a code of ethics (“**Code of Ethics**”) on 28 August 2003 to provide guidelines to the senior management and Directors in legal and ethical matters as well as the sensitivities involved in reporting illegal and unethical matters. The Code of Ethics covers such areas as supervisory rules, insider dealing, market malpractices, conflict of interests, company opportunities, protection and proper use of the Company’s assets as well as reporting requirements.

All the senior management members and Directors are required to familiarise themselves with and follow the Code of Ethics to ensure that the Company’s operations are honest and legal. Violations of the rules will be penalized and serious offences will result in dismissals.

The Company reviewed its Code of Ethics and adopted the revised code of ethics (“**New Code of Ethics**”) in 2005, as part of its continued efforts to improve its corporate governance standards. The Company has provided all its Directors and senior officers with a copy of the New Code of Ethics and require them to comply with the New Code of Ethics, so as to ensure the Company’s operation is proper and lawful. The Company will take disciplinary actions towards any act which is in breach of the New Code of Ethics.

MODEL CODE FOR SECURITIES TRANSACTIONS BY DIRECTORS OF LISTED ISSUERS

The Company’s Code of Ethics and New Code of Ethics both incorporated the Model Code for Securities Transactions by Directors of Listed Issuers (the “**Model Code**”) as set out in Appendix 10 to the Listing Rules. All Directors have confirmed that they complied, during the year ended 31 December 2005, with the required standards set out in the Model Code.

SERVICES AND REMUNERATION OF AUDITORS

Ernst & Young was appointed and engaged as the Company’s auditor (“**Auditor**”) for the financial year ended 31 December 2005. Services provided by the Auditor and fees charged by the Auditor for the services are as follows:

Audit Fees

The aggregate fees billed for professional services rendered by the Auditor for the audit of the Company’s annual financial statements or services that are normally provided by the Auditor in connection with statutory and regulatory filings or engagements were RMB6,750,000 (approximately US\$815,562) for the financial year ended 31 December 2004 and RMB7,961,006 (approximately US\$986,469) for the financial year ended 31 December 2005.

Audit-Related Fees

The aggregate fees billed for assurance and related services by the Auditor that are reasonably related to the performance of the audit or review of the Company’s financial statements and are not reported under “**Audit Fees**” were RMB993,180 (approximately US\$120,000) for the financial year ended 31 December 2004 and RMB2,098,252 (approximately US\$260,000) for the financial year ended 31 December 2005. The audit-related services provided by the Auditor included assistance in the implementation of Section 404 of the Sarbanes-Oxley Act.

Tax Fees

The aggregate fees billed for professional service rendered by the Auditor for tax compliance, tax advice and tax planning were RMB99,318 (approximately US\$12,000) for the financial year ended 31 December 2004 and nil for the financial year ended 31 December 2005.

All other fees

There are no other fees payable to the Auditor for products and/or services provided by the Auditor, other than the services reported above, for the financial year ended 31 December 2004 and for the financial year ended 31 December 2005.

STATEMENT ON CORPORATE GOVERNANCE AS REQUIRED BY SECTION 303A.11 OF THE NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL

The Company is incorporated under the laws of Hong Kong and the principal trading market for the ordinary shares of the Company is the Stock Exchange of Hong Kong Limited. In addition, because the Company's ordinary shares are registered with the United States Securities and Exchange Commission and are listed on the New York Stock Exchange (the “NYSE”), the Company is subject to certain corporate governance requirements. However, many of the corporate governance rules in the NYSE Listed Company Manual (the “NYSE Standards”) do not apply to the Company as a “foreign private issuer” and the Company is permitted to follow its home country corporate governance practices in lieu of most corporate governance standards contained in the NYSE Standards. Section 303A.11 of the NYSE Listed Company Manual requires NYSE-listed foreign private issuers to describe the significant differences between their corporate governance practices and the corporate governance standards applicable to U.S. companies listed on the NYSE. The Company has posted a brief summary of such significant differences on its website, which may be accessed through the following web page:

<http://www.cnoocltd.com/investor/channel/investor1851.asp>

