

PRC Laws and Regulations Relating to the Industry

The manufacture of petroleum drilling rigs and components must comply with the Regulations on the Administration of Production Permits for Industrial Products (《工業產品生產許可證管理條例》), promulgated by the State Council of the PRC on July 9, 2005, and its Implementation Rules (《實施辦法》), promulgated by the State Quality Inspection Bureau on September 15, 2005. Products listed in the Industrial Products Catalogue are subject to the Production Permit System; a manufacturer must not manufacture any product listed in the Industrial Products Catalogue, unless a Production Permit for such product has been obtained.

On December 2, 2005, the NDRC promulgated the Industry Restructuring Catalogue (《產業結構調整指導目錄》), to facilitate industry restructuring in accordance with government policy. This applies to all companies in China and classifies the “Design and manufacture of sets of 7,000 or more meter depth drilling rigs” as an encouraged category.

PRC Laws and Regulations Relating to Foreign Investment

Under the updated Industrial Guidance Catalogue for Foreign Investment (《外商投資產業指導目錄(2007年修訂)》), jointly issued by the NDRC and the Ministry of Commerce on November 30, 2004 and revised on October 31, 2007, effective on December 1, 2007, foreign investment in “Manufacturing of petroleum exploration, drilling and gathering equipment: floating drilling system and floating manufacturing system of working depth > 500m, subsea production and gathering equipment of working depth > 600m, winch of power > 3,000 KW, top drive of 850 KW and above, drilling pump of power > 1,800 KW for deep sea petroleum drilling, underground petroleum driller with drilling depth of 9,000 metres and above and desert petroleum driller, reciprocating piston compressor of 80 tons and above for oil refinery device with capacity of 10 million tons/year, digital-controlled petroleum deep well logging device, petroleum driller mud hole device.” is categorized as an encouraged investment. According to the Provisions on Guiding the Foreign Investment Direction (《指導外商投資方向規定》), and the Comments Regarding Further Encouraging Foreign Investment (《關於當前進一步鼓勵外商投資的意見》), an encouraged foreign investment is entitled to receive certain benefits and incentives from the government, mainly in terms of taxation, including but not limited to: (a) the local income tax of any enterprise with foreign investment, which operates in an industry or undertakes a project encouraged by the state, may be exempted or reduced, at the discretion of the People’s Government of the province, autonomous region or municipality directly under the Central Government; (b) domestic equipment purchased by such enterprise is subject to a VAT Refund Policy; and (c) as to certain foreign investment, equipment imported for the enterprise’s own use, within the total amount of investment, is exempt from tariffs and import-stage value-added tax.

Pursuant to the SAFE’s Notice on Relevant Issues Concerning Foreign Exchange Administration for PRC Residents to Engage in Financing and Inbound Investment via Overseas Special Purpose Vehicles (《國家外匯管理局關於境內居民通過境外特殊目的公司融資及返程投資外匯管理有關問題的通知》), which is SAFE Circular No. 75, issued on October 21, 2005, effective on November 1, 2005, (i) a PRC citizen residing in the PRC, (a “PRC Resident”), must register with the local branch of SAFE before he or she establishes or controls an overseas special purpose vehicle (“SPV”), for the purpose of overseas equity financing (including convertible debt financing); (ii) when a PRC Resident contributes the assets of or its equity interests in a domestic enterprise to an overseas SPV, or engages in overseas financing after contributing assets or equity interests to an overseas SPV, such PRC Resident must register his or her interest in the overseas SPV or any changes to his or her interest in the overseas SPV with the local branch of SAFE; and (iii) when the overseas SPV undergoes a material event outside of China, such as change in share capital or merger and acquisition, the PRC Resident must, within 30 days after the occurrence of such event, register such change with the local branch of SAFE.

Under SAFE Circular No. 75, failure to comply with the registration procedures may result in penalties, including imposition of restrictions on a PRC subsidiary’s foreign exchange activities and its ability to distribute dividends to the overseas SPV.

On August 8, 2006, six PRC regulatory agencies, including the CSRC, promulgated the Provisions Regarding Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (《關於外國投資者併購境內企業的規定》) (the “New M&A Rules”), to regulate foreign investment in PRC

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domestic enterprises. The New M&A Rules provide that the Ministry of Commerce must be notified in advance of any transaction in which a foreign investor takes control of a PRC domestic enterprise, and if any of the following situations exists: (i) the transaction involves an important industry in China; (ii) the transaction may affect national “economic security”; or (iii) the PRC domestic enterprise has a well-known trademark or historical Chinese trade name in China. The New M&A Rules contain a provision requiring overseas SPVs, formed for listing purposes through acquisitions of PRC domestic companies and controlled by PRC individuals, to obtain the approval of the CSRC prior to publicly listing their securities on an overseas stock exchange. On September 21, 2006, the CSRC issued a clarification that sets forth the criteria and process for obtaining any required approval from the CSRC.

Miscellaneous

Protection of Intellectual Property

The PRC laws and regulations concerning the protection of intellectual property include, but are not limited to: the Patent Law of the PRC and its Implementing Regulations (《中華人民共和國專利法》及其《實施細則》); the Paris Convention for the Protection of Industrial Property (《保護工業產權巴黎公約》) of the World Intellectual Property Organization; and the General Principles of the Civil Law of the PRC (《中華人民共和國民法通則》).

Environmental Protection

The PRC laws and regulations concerning environmental protection, include but are not limited to: the Environmental Protection Law of the PRC (《中華人民共和國環境保護法》), promulgated and effective on December 26, 1989, the Air Pollution Prevention Law of the PRC (《中華人民共和國大氣污染防治法(2000年修正)》), promulgated on April 29, 2000, effective September 1, 2000; the Water Pollution Prevention Law of the PRC, and its Implementing Regulations (《中華人民共和國水污染防治法(96修正)》及其《實施細則》), promulgated in 1996 and 2000, respectively; the Rules on the Administration concerning Environmental Protection of Construction Projects (《建設項目環境保護管理條例》), promulgated and effective on November 29, 1998; and the Regulations on Administration concerning the Environmental Protection Acceptance Check on Construction Projects (《建設項目竣工環境保護驗收管理辦法》), promulgated December 27, 2001, effective February 1, 2002.

Pursuant to such laws and regulations, the discharge and disposal of toxic and hazardous materials, including but not limited to a manufacturer’s waste water, solid waste and waste gases, must comply with the applicable national and local standards. Otherwise, a manufacturer may be ordered to take corrective actions within a certain period of time, be subject to penalties, or ordered to shut down. Before a construction project begins, an environmental impact assessment report is required to be submitted to the relevant environmental protection authority for approval, and an acceptance inspection by the relevant environmental protection authority is required before the finished project commences operations.

Taxation in the PRC

On January 1, 2008, the Foreign-funded Enterprise and Foreign Enterprise Income Tax Law of the PRC (《中華人民共和國外商投資企業和外國企業所得稅法》) was abolished, and the Enterprise Income Tax Law of the PRC (《中華人民共和國企業所得稅法》), promulgated on March 16, 2007, became effective. Pursuant to the Enterprise Income Tax Law of the PRC, the income tax rate for both domestic-funded enterprises and foreign-funded enterprises will be 25%.

VAT Refund

Under PRC law, a manufacturing company established in the PRC is entitled to a refund of, or exemption from, certain PRC value-added tax (“VAT”) on its products exported to other countries.

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For details please refer to: the PRC Imported and Exported Goods Taxation Administration Rules (《中華人民共和國進出口貨物徵稅管理辦法》), effective on March 1, 2005; the State Tax Bureau Circular regarding Issues of Tax Refund (or Exemption), for Exported Goods (《國家稅務總局關於出口貨物退(免)稅若干問題的通知》), effective on November 18, 2003; and the Administration Rules regarding Tax Refund (or Exemption) for Exported Goods (《出口貨物退(免)稅管理辦法》), effective on May 1, 2005.

Taxation in the USA

For United States federal income tax purposes, a limited liability company (“LLC”) may be treated as a disregarded entity, a partnership or a corporation. Honghua America, LLC is currently classified as a partnership for United States federal income tax purposes. A partnership is not subject to United States federal income tax itself; rather, income or loss of a partnership “flows through” to the partners, who are taxed in their individual capacities on their distributive shares of partnership taxable income.

Taxation in the State of Texas

Texas recently created the Texas Margin Tax, effective January 1, 2007, with the first returns due in May, 2008. The new tax will impose a 1% “taxable margin tax” on the “taxable margin” of a taxable entity. The taxable margin is determined by first determining a taxable entity’s total revenue. From this amount, the entity will choose to deduct either its cost of goods sold or total compensation, up to \$300,000 per employee, indexed for inflation. If the entity’s taxable margin is greater than 70% of its total revenue, the entity is taxed only on 70% of its total revenue. The entity will then apportion to the state the amount of revenue from business done in the state and will subtract any other allowable deductions to determine the entity’s taxable margin. Once the entity’s taxable margin is determined, a tax rate of 1% is applied to that margin.

Laws of Egypt

Civil law: The Egyptian Civil Law was promulgated on July 29, 1948. The Civil Law governs all civil transactions between individuals or corporations (assigned personal) including contracts, sales, purchases, renting, and pledging.

Corporation law: The Egyptian Corporation Law was promulgated in 1981. It governs the establishment and operation of companies, including limited liability companies and joint stock companies, including but not limited to assembly meetings, board meetings, capital stock and dividend allotment.

Investment law: The Egyptian Investment Law was promulgated on November 5, 1997. It governs investments, including preferential treatment, guarantees, taxes and customs.

Capital market law: The Egyptian Capital Market Law became effective in 1992. It governs the purchase and sale of the stock of companies.

Environmental law: The Egyptian Environmental Law became effective on January 28, 1994. It governs the activities of individuals and corporations that might have an impact on the environment.

Labor law: The Egyptian Labor Law was promulgated on July 4, 2003. It governs employment relations, labor, penalties and work permits.

Financial law: The Egyptian Finance Law was promulgated in 1999. It governs banking and financial transactions.

Export Business

According to the Foreign Trade Law (《對外貿易法》), amended on April 6, 2004, and the Record Filing and Registration of Foreign Trade Operators Procedures (《對外貿易經營者備案登記辦法》), promulgated by the Ministry of Commerce on June 25, 2004, a foreign trade operator, engaging in the import or export of goods or technologies, must make the appropriate filings at and registrations with the Ministry of Commerce or the organization designated by the Ministry of Commerce.

Foreign Exchange

Pursuant to the Regulations on the Management of Foreign Exchange (《外匯管理條例》), as amended on January 14, 1997, payments in international transactions, such as the sale or purchase of goods, in foreign currencies, are not subject to PRC governmental control or restrictions, and certain organizations inside the PRC, including foreign-invested enterprises, may buy, sell and/or remit foreign currencies, at those banks authorized to conduct foreign exchange business, upon providing valid commercial documents. However, approval from the State Administration of Foreign Exchange is required if the transaction involves a transfer of capital, such as the sale or purchase of shares.

On July 21, 2005, the People's Bank of China issued a Public Announcement on Improving the Reform of the RMB Exchange Rate Regime ([2005]16), which announced that the PRC would reform the exchange rate regime by moving to a managed floating exchange rate, based on market supply and demand with reference to a basket of currencies. RMB would no longer be pegged to US Dollars.

Dividend Distribution

Pursuant to the PRC Law on Foreign-funded Enterprises, amended on October 31, 2000, and the Rules for the Implementation of the PRC Law on Foreign-funded Enterprises (《中華人民共和國外資企業法實施細則》), amended on April 12, 2001, before dividends are distributed, a foreign-funded enterprise must pay certain taxes and retain certain funds, such as reserve funds and welfare funds. Upon approval by the competent governmental authorities, foreign investors may utilize RMB dividends to invest or re-invest in enterprises established in China.