

## REGULATION

This section summarizes the principal regulations relating to the businesses of our subsidiaries in the PRC, as well as our operations in Kazakhstan and Ecuador.

### PRC REGULATIONS

#### Industrial Policy

On November 30, 2007, the NDRC and the MOFCOM jointly issued the current Foreign Investment Industrial Guidance Catalogue (the “Catalogue”) which came into effect on December 1, 2007. The Catalogue classifies industries into three categories: encouraged, restricted and prohibited. Industries that are not indicated as any of the above categories under the Catalogue are permitted areas for foreign investment. Except as otherwise stipulated by other laws and regulations, foreign investors are permitted to invest in industries not listed as prohibited categories. Part of industries in the restricted category may be limited to equity or contractual joint ventures, in some cases with the Chinese shareholder as the controlling shareholder. The MOFCOM or the local authorities are responsible for approving foreign investment in China, including the relevant joint venture contracts, articles of association of foreign invested enterprises and other substantial changes to foreign invested enterprises, such as changes to capital, equity transfer and consolidation. Our investments in the PRC are regulated by the foregoing industrial policies, and the core business of our PRC subsidiaries is manufacture of equipment, tools and materials related to oil extraction and oilfield services, which is permitted for foreign investments.

#### Regulations on the Administration of Permits for the Production of Industrial Products

Pursuant to the Regulations on the Administration of Permits for the Production of Industrial Products promulgated by the State Council on July 9, 2005, which came into force on September 1, 2005, the PRC government has implemented a system to issue production permits to enterprises which are engaged in the production of products that fall within the required catalogue. Enterprises which manufacture products that fall under the catalogue are required to apply for and obtain production permits from designated local authorities. According to the Implementation Rule of Work Safety License for Hazardous Chemical Production Enterprises promulgated by State Administrative of Work Safety on May 17, 2004, enterprises which produce hazardous chemical shall obtain the production permits before commencing the production of such hazardous chemical.

Pursuant to Regulations on Safety Supervision of Special Equipment, which was effective on June 1, 2003 and amended by the State Council on January 24, 2009, the production, usage, and inspection of special equipments, such as boiler, pressure vessels, pressure pipelines, are under the PRC government’s safety supervision. And the production of such special equipment shall obtain the permit from the department of safety supervision of special equipment of State Council.

#### Foreign Exchange Control

The PRC State Council promulgated the PRC Regulation for the Foreign Exchange, or the Foreign Exchange Regulations, on January 29, 1996, which was then amended on August 5, 2008. On June 20, 1996, the People’s Bank of China further promulgated the Regulation on the Foreign Exchange Settlement, Sales and Payment, or the Settlement Regulations, which came into effect on July 1, 1996. Pursuant to the Foreign Exchange Regulation and the Settlement Regulation, foreign exchanges required for distribution of profits and payment of dividends may be purchased from designated foreign exchange banks in the PRC upon presentation of a board resolution authorizing distribution of profits or payment of dividends. The Settlement Regulations remove the previous restrictions on convertibility of foreign exchange in respect of current account items, including the distribution of dividends, interest and royalty payments, trade and service-related foreign exchange transactions, while foreign exchange transactions in respect of capital account items, such as direct investment, loan, securities investment and repatriation of investment remain subject to the approval of SAFE.

On October 21, 2005, SAFE issued the “State Administration of Foreign Exchange’s Notice on Relevant Issues Concerning Foreign Exchange Administration for PRC Residents to Engage in Financing and Round-trip

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Investment via Special Purpose Offshore Companies” (Hui Fa [2005] No. 75) (《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》) (匯發[2005]75號)), or Notice No. 75, a public notice which became effective on November 1, 2005. Pursuant Notice No. 75 issued by SAFE on October 21, 2005, which came into force on November 1, 2005, PRC residents are required to register with the local SAFE branch before directly establishing or indirectly controlling any company, referred to in the notice as a “special purpose offshore company”, outside of the PRC for the purpose of capital financing with assets or equity interest in an onshore enterprise in the PRC, and to go through the modification registration procedures after completing an investment in or acquisition of any operating subsidiaries in the PRC via the special purpose offshore company, which we refer to herein as a “round-trip investment”. In addition, any change of shareholding or any other material capital alteration in such special purpose offshore company not involving a round-trip investment, such as a change in share capital or merger and acquisition, must be filed or registered within 30 days from the date of change. The relevant SAFE regulations apply retrospectively to registration of direct or indirect investments made by PRC residents in special purpose offshore companies before the Notice No.75 came into effect.

Pursuant to Notice No. 75, in the event that a PRC resident with a direct or indirect stake in a special purpose offshore company fails to make the required SAFE registration, the PRC subsidiaries of such special purpose offshore company may be prohibited from distributing their profits to their offshore parent and from paying the offshore parent proceeds from any reduction in capital, share transfer or liquidation in respect of the PRC subsidiaries, and the offshore parent’s ability to contribute additional capital or provide loans, whether using the proceeds from the Offering or otherwise, would be impaired. In addition, failure to comply with SAFE registration requirements as described above may also result in liability under PRC laws for evasion of applicable foreign exchange restrictions. Our current beneficial owners who are PRC residents are subject to SAFE notice and have duly registered or filed with the local branch of SAFE as required under the SAFE notice.

On December 2006, the People’s Bank of China promulgated the Administrative Measures of Foreign Exchange Matters for Individuals, setting forth the respective requirements for foreign exchange transactions by individuals (both PRC or non-PRC citizens) under either the current account or the capital account. In January 2007, SAFE issued implementing rules for the Administrative Measures of Foreign Exchange Matters for Individuals, which, among other things, specified approval requirements for certain capital account transactions such as a PRC citizen’s participation in the employee stock ownership plans or stock option plans of an overseas publicly-listed company. On March 28, 2007, SAFE promulgated the Application Procedures of Foreign Exchange Administration for Domestic Individuals Participating in Employee Stock Ownership Plan or Stock Option Plan of Overseas Listed Company, or the Stock Option Rules. The purpose of the Stock Option Rules is to regulate foreign exchange administration of PRC domestic individuals who participate in employee stock holding plans and stock option plans of overseas listed companies.

According to the Stock Option Rules, if a PRC domestic individual participates in any employee stock ownership plan or stock option plan of an overseas listed company, a PRC domestic qualified agent or the PRC subsidiary of such overseas listed company shall, among others things, file, on behalf of such individual, an application with SAFE to obtain approval for an annual allowance with respect to the purchase of foreign exchange in connection with stock holding or stock option exercises as PRC domestic individuals may not directly use overseas funds to purchase stock or exercise stock options. Concurrent with the filing of such application with SAFE, the PRC domestic qualified agent or the PRC subsidiary shall obtain approval from SAFE to open a special foreign exchange account at a PRC domestic bank to hold the funds required in connection with the stock purchase or option exercise, any returned principal or profits upon sales of stock, any dividends issued upon the stock and any other income or expenditures approved by SAFE. The PRC domestic qualified agent or the PRC subsidiary is also required to obtain approval from SAFE to open an overseas special foreign exchange account at an overseas trust bank with custody or stock brokerage qualifications to hold overseas funds used in connection with any stock purchase.

On August 29, 2008, SAFE promulgated “Notice of the General Affairs Department of the State Administration of Foreign Exchange on the Relevant Operating Issues concerning the Improvement of the Administration of Payment and Settlement of Foreign Currency Capital of Foreign-funded Enterprises (Hui Zong Fa [2008] No. 142) (“國家外匯管理局綜合司關於完善外商投資企業外匯資本金支付結匯管理有關業務操作問題的

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通知滙綜發[2008]142號”), or Circular 142, which provides Renminbi capital converted from the foreign currency-denominated capital of a foreign-invested company may only be used for purposes within the business scope approved by the applicable governmental authority and shall not be used for equity investments within the PRC unless specifically provided for otherwise. In addition, SAFE strengthened its oversight over the flow and use of Renminbi funds converted from the foreign currency-denominated capital of a foreign-invested company. The use of such Renminbi may not be altered without approval from SAFE, and may not be used to repay Renminbi loans if the proceeds of such loans have not yet been used. Violations of Circular 142 may result in severe penalties, including substantial fines as set forth in the Foreign Exchange Administration Rules.

### **M&A Rules**

On August 8, 2006, six PRC regulatory agencies, namely the MOFCOM, the State Assets Supervision and Administration Commission, the SAT, the SAIC, the CSRC and SAFE, jointly adopted the Regulations on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, as amended on June 22, 2009, which became effective on September 8, 2006, or the M&A Rules. According to the M&A Rules, mergers and acquisitions of domestic enterprises by foreign investors must be reviewed and approved by the MOFCOM or its local branches. Particularly, the M&A Rules require special purpose offshore companies formed for overseas listing purposes and controlled directly or indirectly by PRC companies or individuals to obtain the approval of the CSRC prior to publicly listing their securities on an overseas stock exchange.

We have been advised by King & Wood, our PRC legal adviser, that because our PRC subsidiary, Hilong Group, was established as Sino-foreign joint venture before September 8, 2006, the M&A Rules do not apply to our corporate restructuring of Huashi Hailong, Reorganization and the Listing.

### **Dividend Distribution**

Pursuant to the PRC Law on Foreign-invested Enterprises, amended on October 31, 2000, and the Rules for the Implementation of the PRC Law on Foreign-invested Enterprises, amended on April 12, 2001, foreign-invested enterprises in the PRC may pay dividends only out of their accumulated profits as determined in accordance with PRC accounting standards and regulations. In addition, a foreign-invested enterprise is required to set aside at least 10% of their respective accumulated profits each year to fund certain reserve funds, until the accumulative amount of such fund reaches 50% of its registered capital. These wholly foreign-owned companies may also allocate a portion of their after-tax profits based on PRC accounting standards to staff welfare and bonus funds. Amounts allocated to these reserve funds and staff welfare and bonus funds reduce the amount distributable as cash dividends. Upon approval of the competent governmental authorities, foreign investors may utilize RMB dividends to invest or re-invest in enterprises established in China.

### **Export Business**

According to the Foreign Trade Law, as amended on April 6, 2004, and the Record Filing and Registration of Foreign Trade Operators Procedures, promulgated by the MOFCOM 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 MOFCOM or the organization designated by the MOFCOM.

### **Protection of Intellectual Property**

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; the Paris Convention for the Protection of Industrial Property of the World Intellectual Property Organization; and the General Principles of the Civil Law of the PRC.

### **Environmental Protection**

PRC laws and regulations concerning environmental protection include but are not limited to: the Environmental Protection Law of the PRC promulgated and came into effect on December 26, 1989, the Air

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Pollution Prevention Law of the PRC promulgated on April 29, 2000 and came into effect on September 1, 2000; the Water Pollution Prevention Law of the PRC amended in 2008 and its Implementing Regulations promulgated in 2000 respectively, the Rules on the Administration concerning Environmental Protection of Construction Projects promulgated and came into effect on November 29, 1998, and the Regulations on Administration concerning the Environmental Protection Acceptance Check on Construction Projects promulgated December 27, 2001 and came into effect on February 1, 2002.

Pursuant to such laws and regulations, the discharge and disposal of contaminants, toxic and hazardous materials, including a manufacturer's waste water, solid waste and waste gases, must comply with the applicable national and local standards. Enterprises which discharge contaminants must report to, and register with, the State Administration for Environmental Protection or their relevant local environmental protection authorities. Enterprises discharging contaminants in excess of the discharge limits or national and/or local standards must pay discharge fees for the treatment of the excessive discharge. A manufacturer which causes severe pollution may be ordered to take corrective actions within a certain period of time. If it fails to do so, such manufacturer may be subject to penalties, or ordered to cease operations.

### **Occupational Health and Safety**

The Standing Committee of the National People's Congress of the PRC promulgated the Production Safety Law on June 29, 2002 to strengthen the supervision and administration of production safety, prevent and reduce safety accidents, protect the safety of life and property, and promote the development of economy. The Production Safety Law provides that enterprises engaging in production activities must comply with the provisions of the Production Safety Law and other relevant laws and regulations concerning production safety. Such enterprises are required to strengthen the administration of production safety, establish and improve the system of responsibility for production safety and ensure a safe production environment. The Production Safety Law establishes a system of attributing responsibility for production safety accidents in the PRC and sets out the requirements with which enterprises engaging in production activities must comply, including (i) designating staff to be responsible for managing production safety; (ii) providing its relevant employees of appropriate safety classes and training to ensure they possess the required knowledge and management skills on production safety; (iii) erecting appropriate safety signage on dangerous equipment and installations; and (iv) ensuring safety-related equipment comply with national or industry standards. Where an enterprise fails to comply with the provisions of the Production Safety Law, the relevant production safety supervision authority may, issue a rectification order, impose a fine, order such enterprise to cease production and operation, or revoke the relevant permits.

Standing Committee of the National People's Congress promulgated the Prevention and Treatment of Occupational Diseases on October 27, 2001, which took effect on May 1, 2002, to prevent, control and eliminate occupational damages, prevent and treat occupational diseases, and protect the health and related rights of employees. Before the establishment of enterprises which may cause occupational damages, their plant shall fulfill certain hygiene requirements. And such enterprises are also required to adopt certain administrative measures to prevent and treat occupational diseases, including (i) setting up and designating department, or organizing or equipping full-time or part-time hygiene professional staffs to be in charge of occupational diseases prevention and treatment; (ii) formulating measures to prevent and treat occupational diseases, occupational hygiene administration rules and operational procedures; (iii) setting up occupational hygiene files and employees' health files; (iv) establishing occupational factor watch and evaluation system; and (v) formulating emergency response plan of occupational diseases and accidents.

### **Taxation**

#### ***Enterprise Income Tax***

On January 1, 2008, the Foreign-invested Enterprise and Foreign Enterprise Income Tax Law of the PRC was abolished, and the Enterprise Income Tax Law of the PRC, or EIT Law, promulgated on March 16, 2007, became effective. Pursuant to the EIT Law of the PRC, the income tax rate for both domestic-invested enterprises and foreign-invested enterprises is 25%.

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On December 15, 2009, the State Administration of Taxation released the Notice on Strengthening Administration of Enterprise Income Tax for Share Transfer by Non-PRC Resident Enterprise (《關於加強非居民企業股權轉讓所得企業所得稅管理的通知》) or SAT Circular 698, retrospectively effective from January 1, 2008 to reinforce the taxation on off-market equity transfers by non-resident enterprises. Under SAT Circular 698, the PRC tax authorities have the discretion to adjust the taxable capital gains in an equity transfer, if the transfer price is deemed not to be determined on an arm's length basis between related parties. The SAT Circular 698 also requires that, if a party in an equity transfer transaction having a withholding obligation fails or is unable to perform its withholding obligation, the non-PRC resident enterprise in that transaction shall file tax declaration within seven days of the equity transfer. The SAT Circular 698 further provides that, where a non-resident foreign investor indirectly transfers equity interests in a PRC resident enterprise by disposing the equity interests in an offshore holding company, and such offshore holding company is located in a jurisdiction where (i) the effective tax rate is less than 12.5% or (ii) does not tax foreign income of its residents, the foreign investor is required to provide the tax authority in charge of that PRC resident enterprise with the relevant information within 30 days of the transfers. Moreover, if a non-resident foreign investor indirectly transfers equity interests in a PRC resident enterprise in the absence of reasonable commercial purposes and use "abusive" corporate structures to evade tax, the PRC State Tax Authority will have the power to re-examine the equity transfer and treat it as if it were a direct transfer of equity interests in a PRC resident enterprise by denying the existence of the offshore holding company.

### ***Value-added Tax***

Under the Provisional Regulation of the PRC Concerning Value-added Tax amended on November 10, 2008 and its Implementing Rules, value-added tax is imposed on goods sold in or imported into the PRC and on processing, repair and replacement services provided within the PRC. Value-added tax payable in PRC is at a rate of 13% or 17% (depending on the type of goods involved) and, in the case of taxable services provided, at a rate of 17%.

### ***Business Tax***

Pursuant to the "Provisional Regulations of the PRC on Business Tax" amended by the State Council on November 10, 2008 and implemented on January 1, 2009 and the "Detailed Rules for the Implementation of the Interim Regulation of the People's Republic of China on Business Tax (2008)" issued by the MOF and the SAT and effective on January 1, 2009, services in China are subject to business tax. The business tax rate is between 3% and 20% depending on the type of services provided. Sale of real properties and other improvements on the land attract a business tax at the rate of 5% of the turnover of the selling enterprise payable to the relevant local tax authorities.

## **KAZAKHSTAN REGULATIONS**

The Kazakhstan Law on Licensing dated January 11, 2007, or the RK Licensing Law, provides for a list of activities subject to licensing requirements, violation of which may result in civil, administrative or criminal liability. Our subsidiary in Kazakhstan has obtained a licence for exploitation of mining production, which allows our subsidiary in Kazakhstan to engage in activities including drilling oil and gas wells, undergrounding and overhauling wells, dismantling equipment, and installing well lifters, after-repair testing of wells, and flushing, cementing, testing, and developing wells. Under Kazakhstan laws, the authorized government authority conducts examination of a licensee's compliance with the qualification requirements through, *inter alia*, annual reports for a reporting year which the licensee is obliged to submit by March 1 following the reporting year.

Under the Kazakhstan Law on Subsoil and Subsoil Use dated June 24, 2010, or the RK Subsoil Law, a subsoil user and its subcontractors must acquire or procure goods, work and services from Kazakhstan producers to the extent that they comply with the requirements in respect of the relevant project technical regulations of Kazakhstan, and with the standards, price and quality comparable to similar work and services provided by non-residents. The RK Subsoil Law determines Kazakhstan content "in personnel", "in goods", "in work" (i.e. services) as well as Kazakhstan "producer". The RK Subsoil Law requires subsoil users to give preference to Kazakhstan producers and personnel during the performance of subsoil use operations.

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Environmental protection in Kazakhstan is regulated primarily by the Kazakhstan Environmental Code dated January 9, 2007, or the RK Environmental Code. Depending on the nature of the industrial activity of a particular user, the Kazakhstan Ministry of Environmental Protection issues permits for environmental emissions and provides for approval of various activities. The RK Environmental Code establishes a “pay to pollute” regime administered by the relevant national and local authorities. Payment of emission fees does not relieve a company from its responsibility to take environmental protection measures and undertake restoration and clean-up activities, as well as to pay fines and compensate damage to the environment. Failure to comply with environmental requirements or cause environmental accidents may result in suspension or ban of a company’s operations, and administrative and/or civil liability as well as criminal liability imposed upon individuals responsible for such failure.

In Kazakhstan, there are a number of regulations governing health and safety. The industrial safety regulations are applicable to our subsidiary in Kazakhstan to the extent that it owns and uses some equipment at hazardous objects and is therefore subject to various technical requirements, including the obtaining of permits, certificates of conformance and insurance in respect of such objects. Our subsidiary has obtained the relevant permits under the relevant regulations. The applicable health regulations impose certain obligations upon a company to ensure health safety of employees, including mandatory insurance of civil liability. Our subsidiary in Kazakhstan has maintained mandatory insurance of civil liability of the employer for causing harm to life and health of employee during performance of labour duties.

The Kazakhstan laws relating to labor matters include the Labour Code and the Rules on Establishment of Quota, Conditions and Order of Issue of Permits to Employers for Attraction of Foreign Labour Force to the Republic of Kazakhstan. Under these regulations, all companies hiring foreign personnel must, subject to certain exceptions, obtain work permits for such employees, which are issued in accordance with annual quotas established by the Kazakhstan government authorities.

Pursuant to Kazakhstan laws, all current account operations, including capital contributions, transfers of dividends, interest and other investment income, may be made without restriction. Only certain capital account operations between residents and non-residents need to be notified to or registered with National Bank of the Republic of Kazakhstan, or the NBRK. Subject to such notification and registration requirements, capital outflows and inflows are registered and monitored for statistical purposes only, but are not restricted.

The principal taxes in Kazakhstan are corporate income tax at a rate of 20% (and 15% for a few types of income subject to withholding corporate income tax), social tax at a rate of 11% (of expenses incurred by an employer as salary (including bonuses and other forms of remuneration) and social package benefits to employees), social insurance contributions at a rate of 5% (of the expenses of an employer payable to an employee as income for the work performed) and value added tax on goods and services at a rate of 12%.

### **ECUADOR REGULATIONS**

The principal regulation of Ecuador governing foreign investment in Ecuador is the Production Code. Under the Production Code and other Ecuadorian laws and regulations, there is no regulatory restrictions on foreign investment in oilfield service industry or the transfer of equity interest in a foreign-invested company in Ecuador.

The Hydrocarbons Law of Ecuador provides that any company engaged in businesses in respect of hydrocarbons (including oilfield service business) shall make a regulatory filing with the Hydrocarbons Direction of Ecuador after its incorporation. Except such filing, no other regulatory approvals, permits or authorizations from any government authorities of Ecuador are required for a company to operate in oilfield service industry.

Under the Monetary Regime Law of Ecuador, the official currency of Ecuador is U.S. dollar. Ecuador does not have its own currency and all the transactions, payments and obligations, shall be settled in U.S. dollars.

Under the Internal Tax Regime Law of Ecuador, income tax rate applicable to a company incorporated in Ecuador is 25%. In addition, the Tax Equity Law of Ecuador provides for a 2% tax of remittance in respect of any remittances of funds abroad, subject to a small number of exceptions.