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Paul C. Yuan

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China's Offshore Petroleum Resources Law—A Critical and Interpretative Analysis

I. Introduction

The long-expected Chinese offshore petroleum law styled as "Regulations of the People's Republic of China on the Exploitation of Offshore Petroleum Resources in Cooperation with Foreign Enterprises" [hereinafter cited as Regulations] has at long last ventured into the world after two whole years of difficult labor. The Regulations, broad and general as it is, is nevertheless China's first petroleum law. Hence its significance cannot be overemphasized.

There are several factors which prompted China to invest in the offshore oil exploration and development. First, with the onshore resources which are conveniently located near the industrial centers in eastern and north-eastern parts of China rapidly diminishing, China has to turn to inaccessible interior regions such as Dzungarian, Tarim, Szechuan, and Tsaidam basins where the largest portion of onshore reserves are believed to exist and where rough terrain and the harsh climate would make it extremely difficult to exploit. Exploiting such regions, it is claimed, would involve so many difficulties that are virtually impossible to be overcome given the present level of technology, let alone the enormous investments that are needed for such a project. According to recent Chinese resources, more than one million square kilometres of offshore areas are believed to contain enormous oil and gas and other mineral resources.¹ Since China's offshore

*Visiting Research Fellow Institute for Marine & Coastal Studies University of Southern California.

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¹ZHANG LI-FENG: MARINE GEOLOGY, p. 71 (1980), Peking.

reserves may be as extensive as or even more extensive than the onshore reserves² and because of the fact that these offshore oil resources are mostly concentrated in shallow-water areas, such as the Bohai Gulf, the Yellow Sea, and the East China Sea where the average depth of water range from 26 meters to 70 meters,³ the offshore exploration and production operations would not be more expensive than onshore operations as long as the water depth does not exceed 250 feet. Second, China's modernization program needs substantial foreign exchange, and oil offers the greatest possibilities for earning foreign currency through export in order to finance the import of industrial technology. Petrochemical industries can provide synthetic textiles and other finished products which can in turn be exported. Third, modernization carries with it burgeoning energy needs, in industry as well as in agriculture. Farm mechanization would not be possible without diesel oil. Fourth, as oil is an important strategic material, it is of paramount importance to develop this material on strategic and political considerations. As most onshore oilfields, including Daqing, China's largest oilfield, are located in the Northeast and Northwest regions near the Sino-Soviet border, they are vulnerable to attacks in the event of hostilities. The establishment of offshore oilfields will reduce China's energy vulnerability. Fifth, offshore oilfields are close to the industrial centers and seaports, thus facilitating transportation and export. Lastly, offshore drilling is an effective way of staking out China's claims to disputed areas of the China's Seas.

It is against the above background that China finally decided on developing offshore petroleum resources as one of its important measures to cope with these challenges. China started offshore test drilling as early as 1968 in the Bohai Gulf, and about twenty exploratory wells had been drilled in the Gulf by 1976, not counting wells drilled in other offshore areas. China is well aware of her limited technical capabilities and economic constraint. It is virtually impossible for her alone to achieve the goal of producing oil from the offshore seabed efficiently and in as a short time as possible without foreign technological investment. As is well-known, China's continental shelf is one of the largest in the world that remains to be tapped for its petroleum resources. And if American oil interests were to participate in this development venture, it would be the largest investment American businessmen have ever made in Asia. China is now pursuing an "open door" policy on petroleum development, both onshore and offshore. Foreign investment will necessarily involve technological, economic, and legal considerations. One of the primary aims of the Chinese offshore petroleum law is to ensure adequate legal protection to foreign oil investors who apparently would not invest in such a multi-billion-dollar project without first being assured of full protection of their interests by law.

²A.A. Meyerhoff has suggested an offshore figure of 4 billion tons and many Japanese estimates go as high as 10 billion tons for the Bohai Gulf alone. See HARRISON, S.S.: CHINA, OIL, AND ASIA: CONFLICT AHEAD? at 43 [hereinafter cited as HARRISON].

³*Supra* note 1, at 73-79.

The present law aims at establishing a broad framework of principles and guidelines to be followed with more detailed regulations and rules controlling all aspects of petroleum operations on the continental shelf. Although the law might not meet our expectations in so far as its comprehensiveness and specificity are concerned, it is China's first offshore mineral code, and in this sense it is worth our attention and close study.

II. Policy Objectives of the Offshore Legislation

The policy objectives of the Chinese offshore petroleum law can be summarized as follows:

- 1) To achieve the maximum possible oil recovery to meet the nation's energy needs and increase reserves of the petroleum resources;⁴
- 2) To utilize as much as possible foreign capital and technology to expedite the exploration and development of petroleum resources;⁵
- 3) To reduce to the minimum obstructions to and interferences with the marine environment;⁶
- 4) To train Chinese technical and management personnel for eventual takeover of petroleum operations.⁷

It should be pointed out that the above objectives are not set forth as a separate section in the Regulations, but instead are enumerated under the various articles governing the petroleum operations.

As to the substance of the objectives it can be easily seen that China plans to achieve expedited exploration and development of the shelf resources through maximum utilization of foreign capital and technology. Since the mining business is a highly risky enterprise, it is extremely important that the law be made sufficiently attractive in its terms and conditions in order to entice foreign capital to invest in it instead of in other less risky businesses. Exploration risks must be taken into account in contracts, and foreign interests adequately protected through legislation in order to encourage foreign investment. In this respect, the present Regulations have expressly stipulated in article 3 protection of "foreign investments in the exploitation of offshore petroleum resources, their share of profit, and other legitimate rights and interests," It further provides for tax exemptions or reductions for imported equipment and materials.⁸ The tax exemption provision is apparently aimed at facilitating transfer of foreign technology to the Chinese and will also be beneficial to foreign contractors. However, the provision could have negative effects on the competitiveness of Chinese made

⁴Regulations of the PRC on the Exploitation of Offshore Petroleum Resources in Cooperation with Foreign Enterprises [hereinafter cited as Regulations], promulgated on Feb. 10, 1982, art. 1 & 16.

⁵*Id.* art. 7 and 12.

⁶*Id.* art. 24.

⁷*Id.* art. 12 and 18.

⁸*Id.* art. 10.

equipment and materials which the present law attempts to protect as can be seen from articles 19 through 21. Thus it is a clear indication that China would have the technology transfer take precedence over the marketing of her own products. China is well aware that in the initial stage this contradiction might not be very acute as most of the technology used in the offshore operations are high technology which the Chinese may not be able to manufacture at the present time or manufacture at competitive cost.

The present law fails to emphasize competition in resource development. The importance of competitive system in accelerating Chinese national economy has been fully borne out by the growing rate of industrial and agricultural output each year as a result of a policy shift from the extreme left to the moderate.⁹ That competition is a driving force in industrial growth should have been driven home to the Chinese leadership after long years of painful experience in industrial management. As it is, the China National Offshore Oil Corporation (CNOOC) is the only organization entrusted by the government with the work of exploiting offshore petroleum resources in cooperation with foreign enterprises.¹⁰ Perhaps the policy goals of offshore petroleum development could be better achieved by several oil companies working in competition under the scrutiny of the central government. Thus the objectives of petroleum legislation could be stated as:

- 1) Maximum economic recovery of petroleum resources to meet the nation's energy needs and export requirement;
- 2) Maximum foreign revenue for the state;
- 3) Minimization of financial risk for the state;
- 4) Maximum utilization of foreign capital and technology;
- 5) Assurance of orderly and timely resource development;
- 6) Adoption of competitive system in petroleum development;
- 7) Maintenance of a balance between petroleum development and protection of environment;
- 8) Training of technical and management personnel through direct participation in exploration and exploitation activities.

In planning its exploration and development programs the host country should have as its principal goal the long term objective of finding and developing adequate petroleum reserves, not the short-run maximizing of national income. It would be edifying in this connection to review the recommendation of the Marine Science Commission in respect of petroleum development policy:

The Commission recommends that leasing and regulatory policies for offshore oil be geared to a rate of development reflecting all aspects of national interests.

⁹Hwa Guofeng, Report on the Government Work, presented before the Second Conference of the Fifth National People's Congress on June 18, 1979, pp. 5-6. Doc. of the Second Conf. of the Fifth Nat. People's Congress of the PRC (1979), Peking.

¹⁰Regulations, art. 5, ¶ 2.

Strong support should be given to accomplishing the analysis necessary to provide a basis for decisions on development rates.¹¹

Because of China's urgency in developing both onshore and offshore petroleum resources, the warning against short-range view in planning petroleum development should be particularly important and timely. For China the first and foremost policy consideration now is how to expedite the exploration and development of petroleum resources, and that both for economic and national security purposes. The Chinese government may look at the development of her continental shelf resources as an important source for increasing the short term supply of domestic oil to meet her burgeoning energy needs and obtaining foreign exchange through export of petroleum. The promulgation of the Chinese offshore petroleum law is an important step toward that goal. After all, the ultimate test of the effectiveness of any mineral law is whether or not it succeeds in bringing about the "maximum ultimate recovery of the resource, at the time when it is needed, and at costs which the contemporary economy can afford—in other words, maximum economic recovery, the maximum addition to the resource base of the host nation's economy."¹²

III. Regulatory and Administrative Agencies

The principal legislative authority for regulation of operations on the Chinese continental shelf is the present Regulations. It provides for cooperative exploitation of offshore oil and gas through contractual relationship between the CNOOC and a foreign enterprise.¹³ Other laws applicable include the Joint Venture Law promulgated on July 8, 1979,¹⁴ Joint Venture Income Tax Law and Individual Income Tax Law, both promulgated on September 10, 1980,¹⁵ Environmental Protection Law promulgated on September 13, 1979, and the recent Income Tax Law of the PRC concerning Foreign Enterprises (hereinafter referred to as Tax Law), and its detailed rules and regulations for implementation.¹⁶

The Regulations delegate authority over the continental shelf to the Ministry of Petroleum Industry (MPI) which represents the government of the PRC in carrying out its ownership rights in respect of the national petro-

¹¹Report of the Marine Science Commission, "Our Nation and the Sea," at 127 (Jan. 9, 1969).

¹²Northcutt Ely, *Policy Considerations in the Development of Mineral Laws*, NAT. RES. J., V. 3, p. 282 (1970).

¹³Regulations, art. 13.

¹⁴Asian Wall St. J. Weekly, July 9, 1979, at 6, col. 1.

¹⁵International Legal Materials, v. XIX, n. 6, Nov. 1980, 1451-52.

¹⁶Income Tax Law of the PRC concerning Foreign Enterprises [hereinafter cited as Tax Law] was adopted at the Fourth Session of the Fifth National People's Congress and came into force on January 1, 1982. Detailed rules and regulations for the implementation of the Tax Law were promulgated by the Ministry of Finance on February 21, 1982. See the People's Daily of the same dates. People's Daily is the Chinese Communist Party organ published in Peking and circulated worldwide. It usually reflects the official views of the Chinese Government.

leum resources.¹⁷ The law also prescribes the manner in which the MPI may develop continental shelf resources. The MPI is the competent authority in charge of the exploitation of petroleum resources lying under the seabed of the continental shelf and determines forms of cooperation with foreign entities. Authority is delegated to the MPI to administer exploration, development, production, and disposition of the national petroleum resources, formulate policies, approve development plans, and prescribe rules and regulations necessary to carry out the provisions of the law.¹⁸ It is not clear from the context of the Regulations whether the rules and regulations established by the MPI shall be submitted to a higher authority for approval before they can become effective. However, it does stipulate that petroleum contracts shall come into force after approval by the Foreign Investment Commission of the PRC.¹⁹

The CNOOC is a state-owned enterprise directly under the leadership of the Ministry of Petroleum Industry having all the attributes of a juridical person. It shall be independently responsible for legal and financial liabilities in all its business transactions. The MPI in turn delegates the authority to exercise the right of ownership of petroleum resources to the CNOOC which is responsible for entering into contractual relationship with a foreign entity in respect of exploration, development, production, and disposition of petroleum resources. However, there is a doubtful point in article 5, paragraph 2 which, according to the New China News Agency (NCNA) English text, reads as follows:

CNOOC is a state corporation with the qualification of a juridical person which has the exclusive right to explore for petroleum within the areas of cooperation and to develop, produce and market it.

Here, the wording "exclusive right" raises some questions as to the rights of foreign enterprises in the contract area. As is commonly understood, when the right is said to be exclusive, it excludes other entities from exercising rights in the same contract area, and this is certainly not the case here. The claim of "exclusive right" in the contract area directly contradicts articles 6 and 7 which expressly provide for cooperative exploitation of offshore petroleum resources with foreign enterprises.

A reference to the Chinese text of the Regulations revealed a possible error in English translation because according to the legislative intent of the law, the Chinese term could also be translated as "exclusive right of control" (or simply "full control") which would be more congruent with the spirit of the law. Of course, this misrepresentation, if true, could be attributable to the flexibility of the Chinese language. By "exclusive right of control" it tries to convey the idea that the CNOOC is the only legal entity that has the full control over the petroleum resources within the contract area,

¹⁷Regulations, art. 4.

¹⁸*Id.*

¹⁹*Id.* art. 4, 23 (¶ 2), and 30.

including exploration, development, production, and marketing. Anyway, the use of the wording "exclusive right" here raises some doubt as to the exact meaning the lawmakers intended to convey.

The two-tier, MPI and CNOOC, administrative system described above looks as simple in structure as it is centralized in power. The powers are highly centralized in MPI and in lesser degree in CNOOC. On matters involving foreign affairs in particular, Chinese leaders still favor centralization of powers, though the system of centralization has proved disastrous to China's economic development over the past decades, and steps are being taken to correct it through decentralization process from the provincial level down. This is what we call "more autonomy to grass-roots units." In recent years some sort of relaxation has been shown in this monolithic structure such as the establishment of special economic zones in Guangdong Province²⁰ whereby the local government is given a freer hand on matters relating to economic cooperation and technical exchange with foreign counterparts. Since the CNOOC is authorized to establish regional subsidiaries, specialized companies and overseas offices,²¹ it can be predicted that a huge bureaucratic structure will be built up over the years and will consequently hinder efficient implementation of contracts.

IV. Forms of Cooperation

There are four principal types of petroleum systems that have been used in the petroleum industry to govern the relations between the host country and the international oil company: the concession (also called "permit," "license" or "lease"), the joint venture, the production sharing contract (or service contract), and full state participation. In any type of these arrangements an agreement is necessary between the host country and the oil company whereby rights and obligations are created. However, it is a special type of contract because one of the parties to the contract is the state or a state agency, which has greater power and freedom of action than a private party and has international status that gives it special recognition abroad for juridical purposes.²²

In recent years the trend is toward greater participation of the state in the petroleum resource development and that solely because the producer countries have perceived the need of controlling this critical resource in order to strengthen its economic and strategic position in the world arena. The concept of direct state participation in the development of petroleum resources has been widely accepted and implemented in many parts of the world, and both developing and developed countries have enacted laws and

²⁰Regulations on Special Economic Zones in Guangdong Province adopted at the Fifteenth Session of the National People's Congress Standing Committee of August 26, 1980, art. 1.

²¹Regulations, art. 5, ¶ 3.

²²Martin, P.H.: Host Country Controls in the Petroleum Industry, paper submitted to the Regulation of International Business, April 12, 1974.

acts that assure them of direct participation in the management of petroleum operations, including the power of determining the rate, price, and distribution of production. The formula commonly adopted is the joint venture, production sharing, or full state participation. Even the United States which has traditionally favored the concession system is now beginning to explore options whereby the government would have an operating interest. The degree of success achieved by the various systems as adopted by different countries varies greatly, and this in large measure "reflects the petroleum potential and the bargaining strengths of the countries involved."²³

The Chinese offshore petroleum law did not explicitly specify what form of cooperation will be adopted for the petroleum industry to govern the relations between the host country and the international oil companies. However, article 7 of the Regulations stipulates that the foreign contractor shall provide "exploration investment, undertake exploration operations and bear all exploration risks," unless otherwise specified in the contract, and that the Chinese will not begin investing until a commercial oil field is discovered. This provision puts China in the position of a sure winner in the oil gamble and the international oil company a possible loser because of the extremely risky nature of offshore development. The Chinese are also realistic enough as to back out from the initial development and production operations. During this period the Chinese seem to play a dual role of policy-making and supervising. The foreign oil company will be responsible for the operations until such time when the Chinese deem it opportune for them to take over the production operations according to the provisions of the contract. In compensation for the investment and expenses incurred by the foreign contractor, he shall receive remuneration out of the petroleum produced according to the provisions of the contract.

From the above analysis, it leaves little doubt that China will opt for either the joint venture or production sharing formula as the main form of cooperation with foreign oil companies.

1. *Joint Venture*

The joint venture system was first started in 1957 when Iran entered into an agreement with the Italian agency ENI and its subsidiary AGIP. The joint venture can be defined as an agreement under which the host country or a national oil company and a private oil company agree to jointly develop and produce petroleum with the oil company assuming all risks and burdens of exploration. If petroleum was found and production begun, a separate operating company jointly owned by the state and a private company will be formed to take over the joint venture operations. This separate legal entity is then authorized to produce and sometimes undertake the

²³R.B. KRUEGER, *WORLD PETROLEUM POLICIES REPORT*, ENERGY LAW SERVICE, (Monograph 13C), Feb. 1981, at 34-35 [hereinafter cited as *World Report*].

marketing of petroleum produced under the agreement. Costs and profits are to be shared according to each party's equity in the enterprise.

The Chinese Joint Venture Law, promulgated on July 8, 1979, establishes a legal framework for the protection and regulation of business enterprises involving foreign and Chinese capital. The successful operation of the joint venture system in countries having similar economies to China's has proved that the system yields more benefit to both parties than any other form of petroleum system.²⁴ Under the joint venture system the host country will obviously reap benefit from foreign managerial and technical expertise, and this will be of particular significance to China's modernization program. This system is also consistent with China's basic policy concerning state control of natural resources.

2. Production Sharing Contract

The production sharing contract differs from the joint venture in that no jointly owned company is created and title to the petroleum produced is vested in the host country until it is disposed of either by selling to the foreign company or marketing abroad. The foreign company actually acts as a contractor to the host country and bears production, exploration, and development expenses and receives in return a certain free share of the annual production (after recovery of cost) or a guaranteed price for a fixed share of the production depending on the agreement. The contractor will also be given the opportunity to market the petroleum produced for a commission. The production sharing formula exempts the host government from any financial commitments in connection with petroleum operations while at the same time allowing the state to participate in the control of petroleum operations. The host country will receive an agreed upon minimum share of production regardless of how much the oil company will have to pay for its exploratory and development costs.

The difference between the production sharing contract and the service contract simply lies in the manner in which the foreign oil company receives compensation. The following paragraph explains the difference in most succinct terms:

If the reward is the guaranteed purchase by [the contractor] of a certain percentage of the annual production at a special [and sometimes] favorable price (and treating the costs as a loan to be repaid by the national oil company with or without interest), [or simply cash payments in some instances], the arrangement is usually known by the general term "service contract." If the reward consists of allowing the contractor a certain free share of the annual production (after recovery of costs), the arrangement is usually known as a production sharing contract.²⁵

²⁴Franko, *International Joint Venture in Developing Countries: Mystique and Reality*, 6 L. & POL'Y INT'L BUS. 315 (1974).

²⁵It was Indonesia which first developed the concept of production sharing contract in 1966, and since then the system has been adopted in as many as 15 other countries, including Egypt,

There are positive aspects of the PSC which are very attractive to a host country like China which has not enough hard currency to finance its oil development and will have to depend in a large measure upon compensation arrangement, i.e. repayment in oil. The PSC system is also consistent with China's avowed policy of self-reliance in its economic construction because the host country's national oil company is given the responsibility to manage the operations and exercise ultimate control with the contractor acting as advisor on matters of importance. Under the PSC as practiced by Indonesia and Brazil, the foreign oil company is obligated to satisfy the host country's domestic oil needs from its share of production for which the contractor receives only a minimal payment. Under the Indonesian PSC model, the title to production equipment purchased by the Contractor pursuant to the work program passes to the host country at point of import and the contractor is required to make rental payments to the host government for use of the equipment. This is different from the Regulations in which article 22 stipulates that all assets purchased and built by the foreign contractor for implementation of the petroleum contract "shall be owned entirely by CNOOC when the foreign contractor has fully recovered its investments for those assets." But the foreign contractor may continue to use those assets in accordance with the provisions of the contract.

The advantages the PSC can offer are important to China as an emerging world power with its burgeoning energy needs and ambitious drive for economic development. The PSC system not only offers possibilities to meet China's expanding energy needs, but also assures a steady reserve of foreign currency through compensation arrangement. As the host country is given the control over the management of oil operations, the system is in tandem with the basic thrust of China's development strategy and long-term off-shore petroleum development.

There seems to be a loophole in article 15 which only provides that articles 3, 8, 9, 10 and 14 of the Regulations shall apply to foreign subcontractors without mentioning article 22. Thus, legally speaking, all assets purchased and built by the subcontractor will not fall under the provisions of article 22.

The Regulations expressly provide for the adoption of bidding system in entering into petroleum contracts with foreign enterprises.²⁶ It has been reported that the Chinese are now experimenting with bidding systems with its domestic contractors in socialist construction. Article 3 of the "Temporary Regulations promulgated by the State Council on Development and Protection of Socialist Competition" states that for those production and

Libya, Nigeria, Lebanon, Jordan, Syria, South Yemen, India, Bangladesh, Burma, Malaysia, Sri Lanka, Philippines, Peru, Bolivia, and Uruguay. Zakariya, *New Directions in the Search for and Development of Petroleum Resources in the Developing Countries*, 9 VAND. J. TRANSNAT'L L. at 563. The production sharing concept is regarded as an important step toward reconciling national and international interests in natural resources development.

²⁶Regulations, art. 6.

construction projects to which work contracts are applicable, bidding systems can be used on a trial basis.²⁷ According to one published report, a Geological Bureau of Yunnan Province had successfully applied the bidding system to an exploration contract for phosphate mining and was reported to have saved JMP ¥43,900 (equivalent to about U.S. \$26,000) for the state, about one fourth lower in cost than the previous similar undertaking.²⁸ The Chinese bidding system for offshore oil development might deviate from the traditional bidding and would be based on the percentage of eventual oil production with which the oil company would be satisfied as payment, apart from drilling obligations and required exploration outlays. Thus the Chinese would benefit from maximization of both profits and oil recovery because the bidder agreeing to the lowest percentage of oil production would generally be accepted. In awarding exploration and development contracts, the Chinese will also consider such factors as experience and competence of the applicants and the quality and feasibility of their proposed work programs.

V. Operations

To entitle the contractor to engage in offshore operations pursuant to petroleum contracts concluded with the CNOOC, he shall establish a representative office in the PRC which will be authorized to represent the contractor in carrying out the terms and conditions laid down in the contract.²⁹ The contractor shall register with a competent authority which the Regulations did not specify but which most probably is the General Administration for Industry and Commerce (GAIC) within a specified period of time from the date of entry into force of the petroleum contract. In addition, the contractor shall, in carrying out various petroleum operations as specified in the contract, establish operational support bases within the territory of the PRC.³⁰

The law requires that the provisions of the petroleum contract be consistent with the rules and regulations of the PRC and relevant state stipulations³¹ and that the petroleum contract become effective upon authorization by the Foreign Investment Commission (FIC).³² The contractor shall submit an overall oil and gas development plan to the Ministry of Petroleum Industry for authorization.³³ Such a plan shall be consistent with the regulations, directives, and rules which the MPI may promulgate from time to

²⁷People's Daily, Jan. 5, 1981, p. 2. The Temporary Regulations was published by Xinhua News Agency on Oct. 29, 1980.

²⁸*Id.* Jan. 19, 1981, p. 2.

²⁹Regulations, art. 14.

³⁰*Id.* art. 17.

³¹*Id.* art. 3, ¶ 2.

³²*Id.* art. 6, ¶ 2.

³³*Id.* art. 16 and 4.

time for compliance.³⁴ The plan shall meet the requirements for conservation of the natural resources of the continental shelf, safety operations, protection of fishery and environment and other marine activities.³⁵ The law also requires that the operator shall carry out petroleum operations in accordance with good international operating practice.³⁶ The law requires that the contractor pay a fee for the use of the mine area.³⁷ There seems to be an error in the English translation released by the New China News Agency. The Chinese term in article 9 concerning payment can be literally translated into English as "a fee for the use of the mine area" which is in effect similar to a rental payment. However, the translator took the liberty of translating it into "royalty," a typical term of mineral law that has its own definition. The use of the term "royalty" here is certainly misleading.

Article 3 of the Regulations provides that the duly authorized government representatives shall have the right to inspect any operational vessel, platforms, construction sites, and other installations. The law further provides that all petroleum produced and saved from the contract area shall be delivered on shore in the People's Republic of China or exported from oil and/or gas metering point of offshore terminals.³⁸

There are no provisions in the Regulations concerning the duration of an exploration and development contract. However, according to the contract concluded in 1980 between China National Petroleum Company and the Japanese National Oil Corporation, the term is fifteen years which, according to the Chinese Joint Venture Law, may be extended to as long as twenty to thirty years or even longer, subject to authorization by the Foreign Investment Commission.³⁹ Under the terms of the above contract concerning the exploration and development of the Bohai Gulf, the Japanese Oil Company is obligated to undertake the risks and portion of the exploratory expenditures during the exploration phase. The development costs will be borne almost equally by both parties, China paying 51 percent of the costs and Japan 49 percent. As to the allocation formula, the contract provides that the Japanese shall receive 42.5 percent of the output over a fifteen-year period. This percentage covers China's repayment of Japanese loans for its investment in the oil development plus interest and fees for JNOC's performance.⁴⁰ Another 42.5 percent goes to China. The remaining 15 percent is earmarked for cost recovery. The length of the exploration period is generally fixed at four to five years with the option to extend for an additional two years. The development phase may range from fifteen to twenty years or even longer.

³⁴*Id.*

³⁵*Id.* art. 24.

³⁶*Id.* art. 16.

³⁷*Id.* art. 9.

³⁸*Id.* art. 25.

³⁹*Law of the PRC on Joint Venture Using Chinese and Foreign Investment* [hereinafter cited *Joint Venture Law*], art. 12. 18 INT'L LEGAL MATS. 1163 (1979).

⁴⁰JAPAN ECON. J., Aug. 21, 1979, at 5, col. 1.

The Regulations provide that CNOOC is the owner of all the data, technical or otherwise, obtained in the course of the petroleum operations. The disposal of the above-mentioned data including transmission to outside the PRC shall conform to the regulations governing control of data and information as stipulated by the Ministry of Petroleum Industry.⁴¹

VI. Disposition of Petroleum

The Regulations stipulate that the petroleum resources belong to the State.⁴² Individuals or entities not authorized by the MPI shall have no right to explore for, develop, produce, and dispose petroleum resources, nor shall he derive any right or benefit therefrom. The Chinese government shall, by the legislation in force, protect the resources invested by the Contractor and other foreign individuals or entities participating in the offshore petroleum operations in the PRC, their profits, as well as other legitimate rights and interests. The law allows foreign contractors to export the petroleum due them and to remit their recovered investment, profits, and other legitimate income.⁴³

In times of crisis, such as war, danger of war, or other emergency situations which are not enumerated, the government of the PRC has the right to requisition by purchase or turn over for use a portion of the whole of the petroleum due to the foreign contractor regardless of whatever terms may have been provided in the petroleum contract. Here again, the English version does not coincide with the Chinese text which should be put this way:

In case of war, danger of war, or in other emergency situations, the government of the PRC shall have the right to requisition *by purchase* (the italicized is the author's) or take over for use a portion or all of the petroleum obtained and/or purchased by the foreign contractor.⁴⁴

The question of possible expropriation is particularly sensitive to foreign investors, especially in a country where political turmoil and power struggle have never been known to cease for the past half century. The new law gives some but not complete guarantee of compensation in the event of requisition. Although one Chinese top official has assured American oil companies that "justifiable compensation" will be paid in case of nationalization,⁴⁵ foreign oil businessmen are still leery of it.

There is also the question of how to define the "danger or threat of war" and "emergency situations." This will have to be left to the mercy of the host government.

⁴¹Regulations, art. 23.

⁴²*Id.* art. 2.

⁴³*Id.* art. 3 and 8.

⁴⁴*Id.* art. 26.

⁴⁵"Some Aspects of China's Work in Economy, Trade and Law," Address by Ren Jianxin, Director of the Legal Affairs Dept., China Council for the Promotion of International Trade, in Washington, D.C. (Dec. 1979).

VII. Environmental Protection

The provisions of the Regulations relating to environmental protection in the offshore petroleum development are couched in very general terms. The law calls for the oil companies participating in the petroleum operations to carry out operations in accordance with good international practice and the laws of the PRC. They shall insure safety in operations, protect fishery and other natural resources, and prevent the air, seas, rivers, lakes and lands from pollution or damage.⁴⁶

However, the law is strangely silent on the effects offshore operations will bring to the navigation. To the author's knowledge, in an earlier draft of the petroleum law the operator was required to reduce to the minimum obstructions to and interferences with navigation. Is it a deliberate omission? If so, then it might be related to the issue of the limit of China's jurisdiction over the continental shelf.⁴⁷ China believes that the offshore operations are carried out well within its own jurisdictional limit, hence interference with navigation should not be an issue to be brought up by other countries. Rather it is an internal problem to be solved among themselves. The second possibility might be that China would not commit itself to such an obligation toward the world community at large. If this were the case, then it would contradict the position taken by the Chinese delegate at the second Subcommittee of the U.N. Seabed Committee in 1973 at which the Chinese working paper submitted by the delegate stated:

The superjacent waters of the continental shelf beyond the territorial sea, the economic zone or the fishing zone are not subject to the jurisdiction of the coastal State. The normal navigation and overflight on the superjacent waters of the continental shelf and in the air space thereabove by ships and aircraft of all states shall not be prejudiced.⁴⁸

This is in line with the 1958 Geneva Convention concerning the legal status of the superjacent waters as high seas.⁴⁹ In order to fully insure the legal status as high seas of the waters lying above the shelf, paragraph 1 of article 5 of the 1958 Convention provides that the exercise of the rights of the coastal state must not result in any unjustifiable interference with navigation and other rights and freedoms of other states as provided for in the Convention. There will be, no doubt, interferences with the freedom of the high seas as long as there is activity on the continental shelf. What the 1958 Convention as well as the Draft Convention prohibits is only "unjustifiable interference."

There is a general statute on environmental protection which is in many ways comparable to the United States National Environmental Policy Act (NEPA). This Chinese "NEPA" is called "The Environmental Protection

⁴⁶Regulations, art. 24.

⁴⁷This issue has been treated in detail in another article by the author which is available upon request.

⁴⁸U.N. Doc. A/AC. 138/SC II/L. 34 (1973).

⁴⁹1958 Convention on the Continental Shelf, art. 2 (1) and (4).

Law of the PRC" (EPL) adopted at the 11th Meeting of the Standing Committee of the Fifth National People's Congress on September 13, 1979 for trial implementation. This is the first environmental law China has ever formulated since the founding of the People's Republic. Its promulgation represents China's major efforts to cope with the ever increasing dangers of environmental pollution which has become so serious in some parts of China and to insure smooth implementation of China's modernization program.

There was strictly speaking no environmental law in China until the promulgation of the present law. Most of the policies on environmental protection work were sporadically contained in talks by leaders of the government at various levels. The first national conference on environmental protection was held in August 1973, during which guidelines governing environmental work were first laid down which can be summarized in thirty-two characters known as "Thirty-Two Character Policy" now incorporated into the environmental law as article 4. Following the first national conference a number of separate regulations were made which include "Tentative Standards of PRC for the Discharge of Industry's 'three wastes' (1974)," ⁵⁰ "Temporary Provisions of PRC on the Prevention of Pollution in Offshore Waters" (1974), ⁵¹ etc. However, these regulations, like any other regulations of the period, had never been implemented in real earnest. It was not until the fall of the "gang of four" that the law and order began to be restored. The Chinese Constitution adopted at the first meeting of the Fifth National People's Congress stipulates for the first time in its article 11 that "The State protects the environment and natural resources and prevents and eliminates pollution and other hazards to the public." In the report on the government's work made at the Fifth National People's Congress Premier Hua said that "to eliminate pollution and protect the environment in a matter of primary importance that is closely related to the welfare of the people at large and which calls for our utmost attention. . . ." ⁵²

The environmental law has thirty-three articles in all and, like NEPA, spell out in very broad and general terms China's national environmental policy and goals, which is to promote environmental considerations in the decisionmaking at all governmental levels from the provinces down to the counties and districts. It includes guidelines concerning the relationship of National Environmental Protection Office which is the Chinese counterpart of the U.S. Environmental Protection Agency, to its local environmental

⁵⁰Reprinted in *SELECTED DOCUMENTS ON ENVIRONMENTAL PROTECTION* compiled by the Environmental Protection Office of the Anshan Steel Corporation, 1975 (?).

⁵¹The Temporary Regulations was reprinted in *SELECTED DOCUMENTS ON ENVIRONMENTAL PROTECTION*. The author is not quite sure whether the Temporary Regulations has been publicly publicized. The English translation is the author's own.

⁵²MA XIANG-CONG, *PRELIMINARY OBSERVATIONS ON ENVIRONMENTAL PROTECTION LAW*, *FAXUE YANJIU* (Legal Studies), No. 2, at 42 (1979).

protection organizations. NEPA requires that all "major Federal actions significantly affecting the quality of the human environment" be accompanied by a detailed statement by the responsible official on the environmental impact of the proposed action.⁵³ Similarly, the EPL requires that an assessment be made of the potential environmental impact on the human environment before any major engineering project can get underway and that the environmental report be subject to approval by competent authorities.

Although there are no specific clauses controlling offshore exploration and development operations, there are, like NEPA, general provisions that are applicable nationwide to all cases insofar as environmental protection is concerned. It stipulates that all enterprises and institutions shall pay adequate attention to the prevention of pollution and damage to the environment when selecting their sites, designing, constructing, and planning production. In planning such projects, a report on the potential environmental effects shall be submitted to the environmental protection department and other relevant departments for examination and approval before designing can be started.⁵⁴ From this it follows that similar requirements will also be imposed on offshore operations such as submission of a report on assessments of the potential environmental effects in the offshore area before offshore engineering projects can get underway.

Article 12 of the EPL specifically relates to the exploitation of mineral resources. It reads as follows:

In exploiting mineral resources, comprehensive surveying, evaluation, and utilization should be carried out. Excavating and mining at random is strictly forbidden, and tailings and slags should be appropriately disposed of, to prevent damage to resources and fouling the natural environment.

Although the clause is directed toward exploitation of land resources, it will be applicable to offshore exploitation as well from the spirit of the law.

Dumping garbage and waste residues into the waters is prohibited. The law specifically prohibits ships from discharging substances containing oil or poison, and other harmful wastes into the water protected by the law. The law provides punishment for those who have violated the environmental law and regulations ranging from criticisms, warnings, fines, paying damages, to an order to stop production until such pollution is brought under control and eliminated. The EPL provides for civil and criminal penalties in case of serious pollution and damage to the environment resulting in casualties or substantial damage to farming, forestry, animal husbandry, sideline production and fishing.⁵⁵

⁵³42 U.S.C. § 4332(C).

⁵⁴The Environmental Protection Law of PRC [hereinafter cited Environmental Law], art. 6.

⁵⁵*Id.* art. 32(2).

1. *Offshore Environmental Regulations*

To the author's knowledge, there was also a statute styled "Temporary Regulations of the People's Republic of China on the Prevention of Pollution of Offshore Waters" approved by the State Council on January 30, 1974 [hereinafter cited as Temporary Regulations] for trial implementation.⁵⁶ The Temporary Regulations was promulgated with a view to preventing pollution of offshore waters by oil or oily mixtures and other harmful substances in order to insure cleanness and safety in offshore areas and harbours. Although most of the regulations related to discharge of oil or oil mixtures and other harmful substances by ships, there were provisions governing factors and mines situated along the sea coast including offshore oil wells. Article 2, paragraph 6 of the Temporary Regulations provides that:

Factories and mines situated along the sea coast (including cabin-washing stations, workshops, or factories for dismantling or repairing used ships, and offshore oil wells) shall discharge oil or oily mixtures and wastes in conformity with the national tentative standards concerning discharge of industrial wastes abbreviated as "three wastes" (waste water, waste gas, and waste slags).

Article 2, paragraph 7 further provides:

Oil terminals, oil refineries, oil docks, and oil loading and unloading facilities near sea areas shall be maintained in good order, and strict measures be taken to prevent oil from escaping, spilling, dripping, and leaking. Investigations shall be made and responsibility affixed in respect of any violations thereof.

There are two exceptions to the provisions of article 2:

- (1) In case of force majeure, where the discharge of oil or oily mixtures by the ship is for the purpose of insuring safety of, or avoiding damage to, the ship or goods, or for the rescue of life at sea.
- (2) Due to damage to the ship, or after discovery of oil leakage and in spite of various measures taken, there is still leakage of oil or oil mixtures from the ship.

A glimpse of the Chinese environmental law shows that the law is still in the developing stage and that most provisions are too general and schematic and is in need for further elaboration. With offshore oil development projects now underway, China will have to enact more laws and regulations to govern the marine environment in the offshore area. The conflict between the protection of environment and petroleum development has become one of the most snarled problems facing the government and the private oil industry in many countries. In a socialist country as China, the problem has not yet assumed such important proportions as there is no private industry to oppose the government's environmental measures. All the government needs to do is to strike a balance as reasonable as possible between the two conflicting interests. As China looks at the oil development as one of the major steps toward expediting its modernization program, it is

⁵⁶*Supra*, note 51.

unlikely that environmental protection will be given high priority consideration that it deserves in China's overall industrial planning.

VIII. Disputes and Violations of the Regulations

The Regulations provide for the resolution of disputes arising out of cooperative exploitation of offshore petroleum resources through friendly consultations, failing which the dispute may be brought before an arbitration body of the PRC or another arbitration body agreed upon by both parties for mediation or arbitration.⁵⁷

Article 14 of the Joint Venture Law provides for conciliation or arbitration of disputes in the case of failure to settle disputes through consultation. It permits either the use of a Chinese arbitral body in Beijing (Peking), under the Chinese Arbitration rules, or another mutually agreed-upon arbitral body outside the PRC, as in Stockholm under its Chamber of Commerce rules. The Trade Agreement between the United States and the People's Republic of China provides an important vehicle for settling disputes between American and Chinese investors. It calls for "friendly consultation, conciliation or other mutually acceptable means,"⁵⁸ failing which arbitration may be resorted to.

The Regulations provide that the Ministry of Petroleum Industry is authorized to impose administrative injunctions on an operator or subcontractor who violates the regulations in conducting petroleum operations by giving him a warning and demanding compliance within a prescribed time, failing which the MPI shall have the right to take other measures, even to the extent of suspending its right to conduct petroleum operations. The parties violating the regulations shall be held responsible for all economic losses as the result of such violations. In case of serious violations, the party involved shall be fined or even be sued by the MPI.

IX. Other Legal Issues

1. *Taxes*

China has recently promulgated "Income Tax Law of the PRC concerning Foreign Enterprises" (hereinafter cited as Tax Law) which was adopted in the Fourth Session of the Fifth National People's Congress and which came into force on January 1, 1982. Detailed rules and regulations for the implementation of the Tax Law were promulgated by the Ministry of Finance on February 21, 1982.

The Tax Law is formulated under the guiding principle of attracting foreign investment and expediting the development of China's economic coop-

⁵⁷Regulations, art. 27.

⁵⁸US-PRC Trade Agreement, art. 8(1).

eration and technical exchange with foreign countries.⁵⁹ Since the crux of the tax issue is the tax rate, the Tax Law is established on the principle of "more profit more income tax, less profit less income tax, and equal treatment" and is applicable to all industries, including petroleum, regardless of whatever nationality a foreign enterprise may be.⁶⁰ It is believed that the tax rate is established on a reasonable basis with a slight slant towards leaving some margin for profit so as to attract foreign investment.⁶¹

The income tax is assessed at progressive rates for the parts in excess of a specific amount of taxable income, with the tax rate ranging from 20 percent for annual income below 250,000 yuan⁶² to 40 percent for annual income above one million yuan, plus 10 percent local tax. As to the creditability of Chinese taxes in the United States, it is highly probable that they would be creditable according to an interview with Mr. Zhang Wenbin, vice-minister of the Petroleum Ministry, who was alleged to have said "The tax issue is under discussion. We now think there will be no problem with the tax credit."⁶³

Since the promulgation of the recent Tax Law does not exclude the applicability of the Joint Venture Income Tax Law promulgated on September 10, 1980, the latter still controls where applicable.

Thus, along with the "Regulations of the PRC on the Exploitation of Offshore Petroleum Resources in Cooperation with Foreign Enterprises" promulgated on February 10, 1982 and a model contract to be available soon, China has almost completed its preparations for going ahead full steam with bidding on its offshore oil exploration and development.

2. Exchange Control

The Regulations simply provide that the foreign contractor may remit abroad the investment it recovers, its profits and other legitimate income⁶⁴ without mentioning whether or not such remittance is subject to foreign exchange control. However, article 11 does provide that the foreign contractor shall open a bank account in accordance with the provisional regulations for exchange control.

According to the Joint Venture Law, the net profit of a foreign participant, as well as the capital funds received upon the venture's termination may be repatriated in currency specified in the contracts, subject, however, to the foreign exchange regulations of the PRC. It was reported that the new foreign exchange controls were issued by the State Council of the PRC

⁵⁹A written explanation submitted by She Min, Vice Minister of the Finance Ministry, to the Fifth National People's Congress, *People's Daily*, December 9, 1981, p. 4.

⁶⁰Statement by Yang Shangkun, Vice Chairman of the Standing Committee of the Fifth National People's Congress, *People's Daily*, Dec. 8, 1981, p. 4.

⁶¹*Supra* note 59.

⁶²Name of Chinese currency often called Ren-Min-Bi (RMBY). One yuan is equivalent to about U.S. \$0.58 at the current rate.

⁶³*CHINA BUSINESS REVIEW*, Nov.-Dec. 1981 issue, p. 24.

⁶⁴Regulations, art. 8.

on December 18, 1980 to become effective on March 1, 1981.⁶⁵ According to this new foreign exchange controls, joint venture and other enterprises with foreign investment are subject to less stringent rules. All their foreign exchange receipts must be deposited with, and payments go through Bank of China. Profits, net of tax, are freely remittable as are all other legitimate earnings, such as royalty payments or license fees, but remittal of foreign capital must go through General Administration of Exchange Control (GAEC), as must assets upon liquidation and is subject to an income tax of 10 percent on the remitted amount.⁶⁶

3. *Technology Transfer*

The urgency for transfer of technology to Chinese personnel during the exploration and development phase is clearly indicated in the new offshore petroleum law.⁶⁷ Article 12 specifically provides that the foreign contractor "is obliged to transfer the technology and pass on the experience to the personnel of the Chinese side." The foreign contractor is also required to give preference to the Chinese personnel in employment, increase the employment percentage steadily and train them in a planned way. Although in the initial stage the foreign contractor will be chiefly responsible for the development and production operations, technology transfer and participation of Chinese personnel in the operations are made mandatory.⁶⁸ This particular emphasis stems from China's basic policy of self-reliance which the Chinese have and will still pursue in its cooperative venture with foreign enterprises.

To the American oil companies, the crucial question is to what extent the Chinese will be allowed to participate in the training and operation of high technology involved in the offshore exploration and development. That is a tough issue that will have to be thrashed out during negotiation of the contract. As we know, the exports of American technology to the PRC are governed by the Export Administration Act of 1969⁶⁹ and the regulations promulgated by the Office of Export Administration,⁷⁰ both of which prohibit the export of technical data and equipment that might be of significance in military use. There are also severe limitations on the training of Chinese personnel and the number allowed to participate in the operations related to technology of military significance. However, in recent years there have been signs of relaxing those restrictions, and that because of changing political situation in the world arena and prospective Sino-U.S. strategic alliance.

⁶⁵THE C. LAW., v. 2, no. 3, May 1981, p. 136.

⁶⁶Income Tax Law concerning Joint Ventures with Chinese and Foreign Investment, art. 4. INT'L L. MATS., v. 19, no. 6, Nov. 1980, 1452.

⁶⁷Regulations, art. 12, 18 to 21.

⁶⁸*Id.* art. 12.

⁶⁹50 U.S.C. § 2401 (1976).

⁷⁰15 C.F.R. § 368-99 (1979).

4. *Joint or Cooperative: A Play of Words?*

The Chinese have invented a new term in mineral law, i.e. "cooperative" instead of "joint" exploitation of petroleum resources as is commonly used. Since both are not proper legal terms, their subtle difference, if any, can only be traced to its etymology. The Webster's dictionary defines "joint" as "united, joined, or sharing with another (as in a right, obligation, status, or activity)" and "cooperative" as "acting or working with another or others to a common end" or "associating with another or others for mutual often economic benefit."⁷¹ Thus it is not difficult to see that the word "joint" connotes sharing in one's right, status, etc., a notion which China rejects on the ground that China, as a sovereign State, is the sole owner of the petroleum resources in the cooperative venture, and under no circumstances shall its right of ownership be shared with foreign enterprises. China may feel that using the word "cooperative" is less "risky" as it is devoid of the idea of sharing one's right and is generally limited to economic purpose. This idea found its full expression in the first article of the Regulations in which the above idea is implied as can be seen from the following paragraph:

[T]hese regulations are formulated to permit foreign enterprises to participate in the cooperative exploitation of offshore petroleum resources of the PRC.

Please note the key words, "permit," "participate," and "cooperative." In other words, "permission" is necessary before a foreign enterprise can participate. Secondly, it will be in the capacity of a participant, as for example a participant attending a conference as different from the host of a conference. Thirdly, its participation in the venture is in the "cooperative" nature.

China has used the term "joint" in the Joint Venture Law. However, that law is different from the present in that the former does not involve offshore mineral resources whose ownership is challenged, at least in certain disputed areas, while the latter does.

The right of ownership of natural resources is a sensitive problem, and it seems that the Chinese leaders have carefully weighed the words they used in order to avoid possible misinterpretations and undesired implications that might be detrimental to China's interest.

X. Conclusion

There have been marked trends since the forties toward direct state participation in natural resources management and control. This state dominance over natural resources can be ascribed to several factors, of which the most important is the host country's awareness of necessity to exert sovereign rights and control over this critical, strategic material. Petroleum has

⁷¹WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY OF THE ENGLISH LANGUAGE, unabridged, 1961, at 501 and 1219.

never assumed such magnitude of importance to a country's existence as it does today and will continue its domineering role in the world energy structure in the foreseeable future unless there is a better energy source to replace it. The second factor is purely economic and originates in the host country's demand for more revenues from petroleum operations. The oil producer finds in the oil not only a source of boundless power called "oil weapon," but also of infinite wealth. Just look at Kuwait, a postage-stamp size country tucked away in the desert area on the upper reaches of the Persian Gulf, which has now become the richest country of the world. The third factor is the national desire to become not only politically but also economically and technologically independent, though this objective is not easy to be realized in a short time. In the Chinese terminology it is called "self-reliance" policy aiming at eventual complete takeover of management and control by the host country over this critical resource.

The most crucial issue involved in offshore petroleum legislation is how to strike a reasonable balance between the interests of the host country and those of the international oil company. As the modern trend is toward increasing governmental role in the management of offshore oil and gas resources, the crux of the question has been boiled down to selecting the most suitable form of government participation. Given China's present political system and its energy policy as has been discussed in the previous sections, the most appropriate form of petroleum system to be adopted will be the joint venture or production sharing formula. Both of them represent an important step toward equalizing the historical imbalance between the oil producing countries and the foreign petroleum companies.

The new Chinese offshore petroleum law is basically a framework law and is substantially based on negotiations. It neither specifies the form of cooperation which is to exist between the state oil company and the contracting party, nor does it contain essential fiscal provisions. However, as China's first mineral code aiming to set out general policies and guidelines governing foreign participation, it, along with the recent Tax Law, has contained essential provisions of attracting and protecting foreign interests in this dynamic field of offshore petroleum development. The new law is basically in line with the laws of most countries governing joint development of offshore oil resources. Although there are a couple of provisions which the foreign investors might not like, such as use of Chinese domestic equipment and material, they are not mandatory and subject to further negotiations. Overall, the law has managed to strike a reasonable balance of interests between China as the host country on the one hand and international oil companies as contractors on the other. The law has pledged in unequivocal terms protection of foreign interests in this highly risky cooperative venture. As we know, the participation of foreign interests in China's cooperative venture does not simply involve financial risks as such but more importantly, political risks as well. The political climate is so important in a cooperative venture of this nature that only when political stability and

peace can be reasonably ascertained in China as well as in the region, could there be any meaningful, long-term commitment of foreign capital in the development of petroleum resources in China's offshore seabeds. In this connection, the limit of China's jurisdiction over its offshore petroleum resources is a major problem that has yet to be settled among the coastal states in the region, and which, if not appropriately handled, might trigger confrontation on a regional scale at any moment.⁷²

⁷²For a discussion of this topic, please refer to another article the author has recently written, which can be obtained upon request.

