CNOOC-Nexen bid tests Harper’s China policy

By Andrew Mayeda and Theophilos Argitis, Bloomberg News

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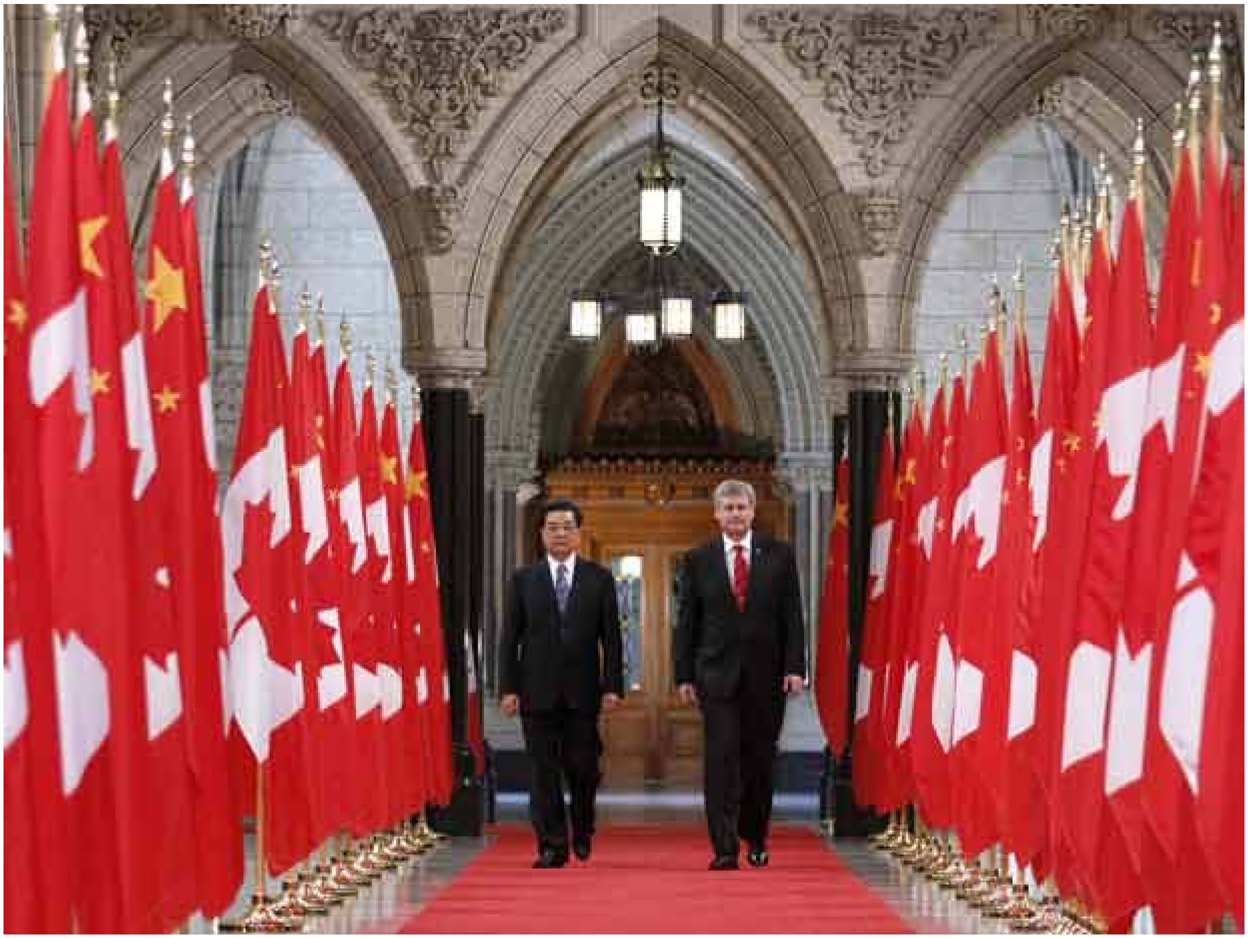

REUTERS/John Major

Canada's Prime Minister Stephen Harper (right) walks with China's President Hu Jintao in the Hall of Honour on Parliament Hill in Ottawa June 24, 2010.

Prime Minister Stephen Harper and his cabinet are wrestling with how to handle the proposed takeover of Calgary-based Nexen Inc. by China’s CNOOC Ltd. as some investors anticipate Canada will block the bid.

CNOOC’s $15.1-billion agreement to buy Nexen, will be part of the discussions when Harper meets his ministers in Ottawa Wednesday, according to a person with knowledge of the matter who spoke on condition he not be identified because the talks aren’t public.

The state-owned company’s bid, which the U.S. is also studying, tests Harper’s ability to balance the need to bolster economic relations with China while ensuring the Asian country doesn’t gain too much influence over the oil sands, the world’s third-largest pool of oil reserves. Options for Harper include capping investments by Chinese enterprises or placing strict conditions on their operations in Canada as allowed under the country's foreign investment law.

Jack Mintz, director of the University of Calgary's School of Public Policy, favors the first option.

"You could see with the amount of capital that's available from China and some of the other Asian countries that they could be back looking at mining companies, they could be back looking at oil and gas companies, and even bigger ones than Nexen," Mintz said yesterday in a telephone interview.

"What's our policy going to be in the longer run?" said Mintz, who is also a board member of Imperial Oil Ltd., the Canadian unit of Irving, Texas-based Exxon Mobil Corp.

Below Offer

Concerns that the deal may not get government approval have kept Nexen's stock below CNOOC's $27.50 per-share takeover bid. The shares reached as high as $26.21 in New York trading the day after the July 23 bid was announced and closed at $25.77 yesterday.

Based on the close, the shares were trading at a 6.7% discount to the offer, the biggest of any Canadian takeover target valued at $1-billion or more, according to data compiled by Bloomberg.

Nexen's oil and gas assets include production platforms in the North Sea, the U.S. portion of the Gulf of Mexico and in Nigeria, as well as oil-sands reserves at Long Lake, Alberta, where it already produces crude in a joint venture with CNOOC. Those assets produced 207,000 barrels a day in the second quarter, which would boost the Beijing-based company's output by about 20%. The acquisition would augment CNOOC's position in Canada's oil sands after last year's $2.4-billion purchase of Opti Canada Inc.

Regulatory Risk

The Nexen takeover needs approval from regulators in Canada, and the U.S., where the Committee on Foreign Investment in the United States examines whether foreign purchases of U.S. assets raise security risks. Senator Charles Schumer of New York has already asked Timothy Geithner, chairman of CFIUS, to block the deal until China gives U.S. companies more access to its market.

Sam La Bell, a research analyst at ***Veritas Investment Research Corp.*** in Toronto, said the U.S. poses a greater regulatory risk for the bid.

"There is an increasing sense that there could be delays in closing the deal due to regulatory issues," ***La Bell*** said Tuesday by phone, citing concerns raised by Schumer.

The Canadian government may have fewer requests for reciprocity, ***La Bell*** said.

"We're happy having the one-way investment coming into Canada," he said. "We'd like to make investments in China but it would never be on the same scale as the U.S."

Under the Investment Canada Act, the federal government reviews acquisitions worth more than $330-million in assets to determine if they represent a “net benefit” to the nation. Under the law, the government can force companies to make written commitments before it agrees to the deal.

Diego Azubel/Pool/Getty Images

During a visit to Beijing in February, Prime Minister Stephen Harper signed a declaration of intent to establish the Canada-China Foreign Investment Promotion and Protection Agreement, marking the end of nearly two decades of negotiations between the two countries.

‘Scrutinized’ Closely

“There is a process in place through the Investment Canada Act to review this transaction and determine if it is a net benefit to Canada,” Carl Vallee, Harper’s press secretary, said in an e-mail. “This transaction will be scrutinized very closely.” He declined to comment on cabinet discussions.

“I met Hu Jintao once, and he said five words to me, ‘We like your oil sands.”

Harper’s government rejected a $40-billion hostile bid by Melbourne-based BHP Billiton Ltd. for Potash Corp. of Saskatchewan Inc. in 2010, in what was only the second rejection of a foreign takeover in Canada in 25 years.

Harper said Jan. 26 in a speech in Davos, Switzerland, that diversifying Canada's energy exports to Asia had become a "national priority" in a bid to reduce the country's reliance on the U.S., and he travelled to China in February with a delegation of business executives. Canada sent 98.5% of the crude oil it exported last year to the U.S., according to National Energy Board data.

Foreign Investors

In February, Canada and China concluded negotiations on an agreement that would protect foreign investors from discrimination by either country's government.

Canadian officials, including Trade Minister Ed Fast, also have pressed China to ease restrictions in sectors such as financial services and mining.

"This lack of openness is an obvious source of frustration for Canadian investors, particularly given the recent dramatic increase in Chinese investment in Canada," John Manley, a former foreign minister who heads the Canadian Council of Chief Executives, an industry group of the country's top CEOs, said in a Nov. 21 speech in Beijing. "Canadian investors ought to be afforded the same access to China that Chinese investors are afforded."

Peter Hunt, a Calgary-based CNOOC spokesman, declined to comment in an e-mail on the reciprocity issue. Davis Sheremata, a Nexen spokesman, declined to comment on the matter when reached by phone.

Direct Investment

Canadian direct investment in China was $4.5-billion in 2011, less than 1% of Canada's total, according to Statistics Canada. Chinese investment in Canada totaled $10.9-billion last year, about 1.8% of the total.

The Canadian government should push for an investment treaty that would require China to automatically approve foreign takeovers by Canadian companies of equivalent size to the Nexen acquisition, Roger Martin, dean of the University of Toronto's Rotman School of Management, argued in an article published in the Globe and Mail on July 26.

"If the answer is no, we should turn down the Nexen acquisition on the principle of the absence of reciprocity," he said in the article.

The rejection of the Potash Corp. takeover has increased uncertainty among investors about what kind of foreign acquisitions Canada will accept, said John McCallum, a Liberal lawmaker.

The government could use the foreign-investment treaty it plans to sign with China as a way to implement "some form of reciprocity," McCallum, a former defence minister and former chief economist at Royal Bank of Canada, said by phone.

'Five Words'

“I met Hu Jintao once, and he said five words to me, ‘We like your oil sands,’” McCallum said last week of the Chinese president. “The fact they’re asking us to accept a $15-billion investment sort of gives us the right to say, ’OK, we just want the same treatment.’”

Enforcing reciprocity with China would be tricky, said Lawrence Herman, a lawyer at Cassels Brock & Blackwell LLP in Toronto who specializes in international trade.

“Are we talking about reciprocity in general terms, or are we talking about equivalent treatment in the same sector under the same or equivalent circumstances involving the same or similar kinds of investors?” Herman said in a telephone interview.

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REUTERS/Petar Kujundzic/Files

A woman walks past the entrance of the headquarters of China National Offshore Oil Corp (CNOOC) in Beijing.

Inserting a reciprocity clause into any trade treaty with China may also violate international trade laws, since Canada would enjoy access to the Chinese market that other countries do not, Herman said.

“If the government of Canada is concerned about reciprocity or the lack thereof in any kind of foreign acquisition, it should state the policy openly before the investment is made so that the world knows that there is a requirement for some kind of balanced treatment for Canadian investors,” Herman said.

China’s Ministry of Commerce has yet to receive notice of any reciprocity requests from its Canadian counterpart and will not take action unless Canada raises the issue, a Chinese ministerial official said today by telephone. The official, who answered the commerce ministry spokesman’s office line, declined to be named, citing internal policies.