



INVESTMENT CANADA ACT: SOE GUIDELINES AND CNOOC/NEXEN

Foreign Investment by SOEs: Green Light/Red Light

December 2012

Canada's Prime Minister sent a clear message today that the country remains open to foreign investment, including investment on a significant scale by state-owned enterprises (SOEs) in certain circumstances. However, continued acquisitions by SOEs of controlling interests in the oil sands industry has been largely constrained and will be found to be of net benefit to Canada only on an exceptional basis going forward. The acquisition by SOEs of non-controlling interests, including joint ventures, will continue to be welcome.

The Prime Minister's address followed the announcement by the Minister of Industry, which was communicated by way of press release, of:

- **approval of** both [the proposed acquisition by China National Offshore Oil Company \(CNOOC\) of Nexen Inc.](#) and [the proposed acquisition by PETRONAS of Progress Energy Ltd.](#), finding each likely to be of "net benefit" to Canada in light of the existing provisions of the *Investment Canada Act* and the former SOE Guidelines;
- **updated SOE Guidelines**, including expansion of the definition of an SOE to include not only those entities that are owned by a foreign state, but also entities that are influenced directly or indirectly by a foreign government. The updated SOE Guidelines require all SOE investors to demonstrate their commitment to transparent and commercial operations and the extent of influence by the foreign state; and
- **the imminent increase in the review threshold under the *Investment Canada Act* for direct acquisitions of control by WTO Investors will not apply to SOE investments:** once regulations are finalized (expected in 2013), the review threshold for direct investments by WTO Investors will increase to \$600 million based on the enterprise value of the Canadian business, increasing over four years to \$1 billion. These increases will not apply to investments by SOEs, for which the current threshold of \$330 million based on the book value of assets will continue to apply.

Stikeman Elliott represents
CNOOC in its acquisition
of Nexen Inc.

The impetus for making the announcement at this time was the proposed CNOOC transaction, valued at \$20 billion (including the assumption of debt), in addition to the proposed \$6 billion acquisition of Progress Energy Ltd. by PETRONAS of Malaysia.

In connection with CNOOC's transaction specifically, the Minister announced that he was satisfied that the transaction was likely to be of net benefit to Canada and that the transaction meets the criteria of the *Investment Canada Act*, including the former SOE Guidelines. The Minister reported that CNOOC had, in connection with its application for approval of the proposed transaction to acquire control of Nexen Inc. under the *Investment Canada Act*, "made significant commitments to Canada in the areas of: governance, including commitments on transparency and disclosure; commercial orientation, including an adherence

to Canadian laws and practices as well as free market principles; and employment and capital investments, which demonstrate a long-term commitment to the development of the Canadian economy.”

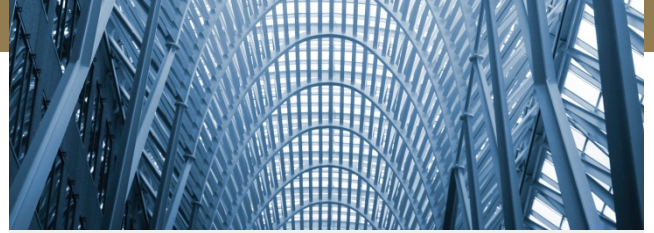
The Minister’s announcement came after prolonged public and political discussion of the perceived increase in SOE acquisitions in Canada. It is consistent with the Government of Canada’s desire to encourage foreign investment following its 2010 rejection, under the *Investment Canada Act*, of the last sizable proposed acquisition of a Canadian company—BHP Billiton PLC’s proposed \$38 billion acquisition of PotashCorp.

The *Investment Canada Act* requires, generally, that the Minister review and approve any acquisition of a Canadian business over a certain size on the basis that he is satisfied that it is likely to be of “net benefit” to Canada. The *Investment Canada Act* spells out six factors, largely economic, which the Minister must consider. In addition, pursuant to guidelines on SOEs (SOE Guidelines) released in late 2007, acquisitions above the financial threshold by SOEs are subject to incremental review for the purposes of ensuring that the Canadian business will continue to be run on a commercial basis, with sufficient transparency and commitments to Canadian standards of corporate governance to ensure this is the case.

A number of acquisitions by SOEs have been approved under the *Investment Canada Act* since the former SOE Guidelines were released, including the acquisition by PetroChina International Investment Company Limited (PetroChina) of oil sands assets for \$3 billion and Sinopec International Petroleum Exploration and Production Corporation’s acquisition of Daylight Energy Ltd. for \$4 billion. However, the proposed CNOOC transaction changed the landscape and put renewed political pressure on the Canadian government to articulate its approach to SOE investment generally. Today, while approving each of the CNOOC transaction and PETRONAS transaction under the former SOE Guidelines, the government provided clarity that future acquisitions by SOEs will be subject to a more stringent standard.

Generally, the new SOE Guidelines provide:

- Investments by foreign SOEs to acquire control of a Canadian oil sands business in particular will, going forward, be found to be of net benefit *on an exceptional basis only*.
- The Minister will carefully monitor SOE transactions throughout the Canadian economy in general. In particular, the Minister will closely examine:
 - the degree of control or influence a state-owned enterprise would likely exert on the Canadian business that is being acquired;
 - the degree of control or influence a state-owned enterprise would likely exert on the industry in which the Canadian business operates; and
 - the extent to which a foreign state is likely to exercise control or influence over the state-owned enterprise acquiring the Canadian business.
- Non-controlling minority interests in Canadian businesses proposed by foreign SOEs, including joint ventures, will continue to be welcome in the development of Canada’s economy.
- Free enterprise principles and industrial efficiency will be considered in reviews where the investor is owned, controlled or influenced – directly or indirectly – by a foreign state.
- The Minister will be afforded the flexibility to extend the timelines for national security reviews to give the Government the time it needs to conduct careful and thorough reviews of complex proposed investments that could be injurious to national security.



With respect to all potential investments other than those by SOEs, the Government reiterated that, based on a recommendation by the Competition Policy Review Panel in 2008, the Government will be progressively increasing the review threshold to \$1 billion. The basis for the calculation will be changed from asset value to enterprise value to reflect the market value of businesses and capture the increasing importance of the service and knowledge-based industries of the Canadian economy. In the case of investments by SOEs, the existing net benefit threshold of \$330 million in asset value will remain in place and will be adjusted annually to reflect the change in nominal gross domestic product in the previous year.

The new SOE Guidelines provide greater clarity in respect of how SOEs can participate in the development of the Canadian economy, leaving the door open to certain SOE investments while at the same time constraining the potential for future investment in the oil sands industry. Given the magnitude of the required capital injections required to make significant investments in Canadian oil and gas exploration and development, particularly the oil sands industry, the new SOE Guidelines may impede escalated SOE participation in that sector, with a resultant drag on the speed and degree of such development.

ABOUT STIKEMAN ELLIOTT

Stikeman Elliott acted on behalf of CNOOC, PetroChina and PotashCorp. in respect of the transactions referred to in this document. Our firm is widely recognized as having Canada's most internationally oriented lawyers, and has been involved in many of the country's most significant inbound investment transactions.

With offices in Toronto, Ottawa, Calgary, Montreal and Vancouver as well as in London, New York and Sydney we are able to provide superior legal service to clients worldwide. The firm is recognized as a Canadian leader in each of our core practice areas – corporate finance, M&A, corporate-commercial law, banking, structured finance, real estate, tax, insolvency, competition/antitrust, employment and business litigation – and we are regularly retained by domestic and international companies in a wide range of industries.

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