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CANADA REPORT

BLACK GOLD RUSH

By Julie Treidman

Chinese companies are buying Canada's energy assets, and a trio of Toronto-based firms are helping them do it.

Photograph By Daniel Wood

RECOGNIZING OPPORTUNITY: OSLER PARTNERS (LEFT TO RIGHT) TRISTRAM MALLETT, CHRISTOPHER MURRAY, ROBERT DESBARATS, AND FRANK TURNER

On June 25, as the G20 met in Toronto, the grand, century-old Chateau Laurier in Ottawa became the stage for an unprecedented display of Canadian-Chinese economic knot-tying.

Roughly 150 political dignitaries, executives, and legal counsel were herded into a ballroom for signing ceremonies related to 11 separate energy and natural resources investments by Chinese state-owned companies. After short speeches by ministers from both countries, the Chinese and Canadian executives were called up front to sign various deal documents.

Watching from the audience were lawyers from most of Canada's elite law firms, who had shepherded the deals to this point. "It was this giant blowing of kisses," says one of these lawyers.

Two particularly splashy unions highlighted in the ceremony made headlines. China Petrochemical Corporation—better known as Sinopec Group—closed on its $4.65 billion purchase of ConocoPhillips Corporation's 9 percent stake in the massive Syncrude Canada Ltd. project, the largest Chinese acquisition of a producing oil sands venture to date. And China National Petroleum Corporation (CNPC), China's largest oil and gas company, signed a memorandum of understanding with Encana Corporation, one of Canada's crown jewel natural gas companies, for a multibillion-dollar long-term investment in proposed shale gas projects in Western Canada.

The two oil deals represent a new level of play by the Chinese. Previous Chinese investments in Canadian companies had been small, involved overseas assets, or were for fields not yet in production. "The significance of [Syncrude] is that it's in Canada," says Sinopec's Canadian counsel on the deal, Calgary-based M&A partner Michael Laffin of Blake, Cassels & Graydon. Meanwhile, CNPC's letter of intent with Encana is widely seen as a step toward supplying fuel directly to China via pipelines such as the proposed one now under regulatory review.

CNPC hasn't publicly named its outside lawyers on the Encana letter of intent, but sources close to the deal say Osler, Hoskin & Harcourt is on the file; Blakes, Osler, and Stikeman Elliott have represented buyers in virtually all of the major China-Canada energy deals in the past five years. They've won the work largely through referrals from regular outside international counsel and investment bankers, through wider name recognition outside Canada, and, more recently, through targeted marketing efforts. The Calgary-based powerhouse oil and gas firms—Bennett Jones, MacLeod Dixon, and Burnet, Duckworth & Palmer—have not, by contrast, scored any Chinese clients yet. But they are capturing some of the next wave of Korean, Indian, and Japanese clients. Bennett Jones, in a bid to get Chinese outbound work, opened a new Beijing office on September 29.

There are some disadvantages to representing Chinese acquirors, which may be paying premiums for energy assets but not for legal services. According to two partners from different firms, Chinese companies almost always require their outside counsel to offer significant discounts on hourly legal fees—though firms won't say how much—and very often demand a hard cap on fees. If there is a modest "success fee" for lawyers, there is also likely to be a corresponding "broken deal" discount. "They don't pay anyone what I'd call 'rack rate,' " says one lawyer.

But make no mistake about it, say Calgary deal lawyers: The Chinese are prize clients. In an environment where private equity buyers have stayed on the sidelines in energy dealmaking, and many strategic buyers hesitate to take on new risks, the new state-owned clients are the biggest game in town. "These are the type of clients we want to work with," says Osler oil and gas partner Frank Turner. "They are an entrée into the biggest deals in the world right now."

THE CHINESE BEGAN TESTING the waters in North America in earnest a little over five years ago in simultaneous oil and gas plays in Canada and in the United States. Their early efforts, however, played out starkly differently on either side of the border. CNOOC Limited's $18.4 billion takeover bid for U.S.–based Unocal Corporation in June 2005 triggered domestic U.S. opposition. In August 2005, after Congress threatened to block the company's bid on national and economic security grounds, CNOOC dropped its bid.

CNOOC had better luck up north. A few months before its Unocal offer, it struck a $124 million deal with Calgary-based MEG Energy Corp. to acquire a 17 percent stake in an oil sands project then under development. Shortly after that, a Sinopec subsidiary, tapping Blakes, announced that it would acquire a 40 percent stake in a northern Alberta oil sands project owned by Canada's Synenco Energy Inc. for $84 million. Both deals, as small minority stakes involving not-yet-producing assets, aroused little public interest or concern.

But the Unocal failure, along with a failed takeover bid for Canadian mining company Noranda Inc., left the Chinese traumatized, say deal lawyers. For the next few years, the Chinese avoided both the U.S. and Canada, looking for energy investments in other parts of the world. Strangely, in Kazakhstan, West Africa, and other exotic locales, the Chinese would again intersect with Blakes, Osler, and Stikeman. The relationships that each of these firms struck in the Caspian and elsewhere have continued and deepened today as the deals have gotten larger and more important.

Osler was the first Canadian law firm to hook a Chinese state-owned company on a major Canadian-sided oil deal. In mid-2005, just after the failed Unocal bid, CNPC made a play for PetroKazakhstan Inc., a Calgary-based, Toronto stock exchange–listed company that was at the time the second-largest oil company in Kazakhstan.

Like several other large Canadian oil companies, PetroKazakh-

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stan had leveraged its expertise in Alberta to acquire some of the best undeveloped assets worldwide. But in early 2005, the Kazakh government had gone after the company on a dizzying array of trumped-up charges, leading to the jailing of some local executives. The company put itself up for sale.

PetroKazakhstan accepted a $4.2 billion bid by CNPC in August; CNPC, in turn, needed Canadian counsel to guide it through a transaction that would involve the Canadian capital markets as well as the Canadian courts, which had to bless the company's sale and delisting in Canada via a plan of arrangement under Alberta's corporate statute. CNPC's regular international counsel, Lynn McCaw at what is now Dewey & LeBoeuf, directed CNPC to Osler after other firms were conflicted out.

The PetroKazakhstan deal tested the mettle of the Osler lawyers—including Douglas Bryce in New York, Clay Horner in Toronto, and Tristram Mallett in Calgary—like few other deals. At the eleventh hour, Russia's state-controlled OAO Lukoil, which had a joint venture with PetroKazakhstan, objected to the takeover. Lukoil claimed that the deal impaired rights that it acquired under a change of corporate control. The Kazakh government also objected to the sale, claiming that its state-owned company, Kazmunaigaz Natsionalnaya Kompaniya AO (better known as KMG), also had the right to buy the company at the accepted price.

Shareholders approved the sale in October 2005; CNPC, for its part, agreed to resell 33 percent of its stake to the Kazakh government. But the dispute with Lukoil moved into international arbitration, and it took five years—until this past August—for PetroKazakhstan, assisted by Mallett, to reach a settlement with Lukoil.

In February 2006 Osler stepped up efforts to drum up other Asian and Middle Eastern sovereign wealth fund and state-owned oil company clients. The firm developed "coverage teams," groups of partners focusing on India, China, and the Middle East. That same month, Osler lured Kevin Cramer over from Jones Day. As head of Jones Day's Hong Kong office from 2000 to 2003, Cramer had hired some 25 Chinese lawyers. Some of his recruits had moved on to senior counsel positions in state-owned companies. One of those connections got Osler a foot in the door with another important client, the China Investment Corporation (CIC). Its first role for CIC was advising on a $500 million secured convertible debenture investment in Toronto-listed SouthGobi Energy Resources Ltd. In March 2010 CIC asked the firm to put together a proposal for its largest Canadian investment yet: a $1.2 billion joint venture with and an equity investment in Canada's Penn West Energy Trust.

"We recognized opportunity," says Osler's Turner, who worked on the CIC deal. "And we followed up relentlessly."

Stikeman, the Toronto-based banking and capital markets powerhouse, was particularly well placed to capture some of the Chinese outbound work to Canadian companies. The firm already had a name in Asia, where it handled legal work related to the Canadian business interests of the family of the Hong Kong billionaire Li Ka-shing, including the acquisition of a majority stake in Husky Energy Inc. The firm also had a strong energy practice.

As Lukoil's counsel, Stikeman was conflicted out of the PetroKazakhstan megadeal. But in October 2006, through a referral from Australia's Allens Arthur Robinson, it nabbed a new client, CITIC Group, a Chinese state-owned conglomerate, in its $1.9 billion bid for the Kazakh oil assets of Canada's Nations Energy Company Ltd. At the time, it was the third-largest oil and gas acquisition by a Chinese company. CITIC tapped David Lefebvre, a Calgary-based M&A partner, as its primary outside counsel for that deal, and called him again 18 months later, when CITIC agreed to sell a 50 percent stake of that company to Kazakhstan's JSC KazMunaiGas Exploration Production for $930 million. "That really got us into a lot of big oil and gas assignments," says Lefebvre, who heads Stikeman's China practice. "We'd have more if it weren't for conflicts." (CITIC Resources Holdings Limited's general counsel did not respond to e-mails requesting information about the company's relationship with Stikeman.)

Lefebvre continues to be among the most sought-after Calgary M&A lawyers on Asia-sided deals. Through a referral from Sinopec's international counsel, Vinson & Elkins's Paul Deemer, Lefebvre was tapped in 2008 by Sinopec for its $1.9 billion acquisition of another Canada-based overseas oil company, Tanganyika Oil Company Ltd. And an even bigger prize came last year, when Lefebvre handled Sinopec's $7.3 billion acquisition of Toronto-listed Addax Petroleum Corporation, at the time the largest outbound investment of any kind by a Chinese state-owned company.

Ever since Blakes handled Sinopec's first foray into Canada, the $84 million acquisition of a stake in Alberta's Northern Lights oil sands project from Synenco, Sinopec has continued to be a client. The $4.65 billion Syncrude deal is the most recent evidence of that. (Like the other Chinese state-owned companies listed here, Sinopec did not respond to e-mail inquiries about its outside counsel choices.)

Until September, when Bennett Jones opened its Beijing office, Blakes was the sole Canadian firm of any size with a physical presence in China. Both Osler and Stikeman closed their Asian offices in the late 1990s, and have no plans to reopen them. Blakes's representative office opened in Beijing in 1998 and is staffed by partner Robert Kwauk, a Canadian who speaks Mandarin and Cantonese; two Chinese consultants; and a rotating cast of visiting lawyers from the firm's Canada offices. The China work is picking up speed; in the past few years, the firm has seen a steady stream of work not just from Sinopec, but from other state-owned companies, as well as private Chinese companies, in a variety of sectors. To underscore the firm's commitment, managing partner Robert Granatstein has tapped a senior partner in each office to assist in the China initiative. In Calgary, that partner is Michael Laffin.

"You have to have that foundation and a partnership that is willing to invest in making it a priority," says Laffin. "It is a priority for us."

THE CANADIAN OIL SANDS contain roughly 170 billion barrels of recoverable crude, behind only Saudi Arabia's reserves. But new extraction technology means that the estimate of recoverable oil in Canada could reach 320 billion barrels within the decade.

At this point, just under 5 percent of Canadian reserves are essentially in Chinese government hands. But both the pace and size of Chinese acquisitions is increasing. Last year Chinese state-owned companies spent a record $32 billion on energy and mining acquisitions, paying an average premium of 20 percent, according to Bloomberg data.

Inside Canada, the uptick is triggering a frisson of regulatory concern. For the first time, one of the larger Chinese investments hit an unexpected regulatory speed bump recently. Last fall Industry Canada, which examines significant transactions involving Canadian companies, insisted on reviewing PetroChina International Investment Co. Ltd.'s August 2009 purchase of a 60 percent working interest in two oil sands projects under development by the Athabasca Oil Sands Corp. (AOSC).

PetroChina's lead lawyer at Stikeman, Christopher Nixon, and AOSC's lawyer at Burnet, Duckworth & Palmer, Alicia Quesnel, say that they made a vigorous case that the deal, which involved nonproducing assets, did not require review under foreign investment rules. But regulators disagreed. Ultimately, in late December, they required the Chinese to sign additional agreements, known as undertakings, to reassure the government that the deal was in Canada's interest.

The details are not public, but according to reports in the Canadian press, the undertakings included the following general assurances: that Canadians remain in decision-making positions within the new entity, and that the entity make decisions that are commercial, rather than political, in nature. "[The review] was very significant" as an extension in regulatory authority, says Quesnel. "It showed a shift."

In other deals, however, regulatory reaction has been muted. Canada's foreign investment and ownership rules are similar to those elsewhere. But unlike the powers that be in other jurisdictions—the United States, Australia, and others—Canadians "have never been painted with that brush, that we are unfriendly," says Osler's Turner.

Meanwhile, the U.S., Canada's biggest trading partner, has shown some wariness about the potential environmental impact of oil sands development. To Canadian eyes, the Obama administration appears at best indifferent to Alberta's oil resources. In July an environmental group posted billboards in four U.S. cities calling for a boycott of travel to Alberta: "Alberta: The Other Oil Disaster," the ads proclaimed, showing dead ducks floating in a wastewater pool. "The perceived U.S. attitude toward the oil sands has resulted in Canada being far more open to other customers," says Bennett Jones vice-chair Perry Spitznagel.

By contrast, the Chinese, focused like a laser on their own energy security, are brimming with enthusiasm for Canada. They are increasingly bumping up against the Koreans, the Japanese, and the Indians in Calgary's mile-square grid of prime office towers, each on the hunt for fresh investments. "It's been like the United Nations here," says Spitznagel. His firm has been tapped twice by the Korea National Oil Corporation; in October 2009 the firm represented KNOC in its first big oil acquisition in the country, the $3.9 billion acquisition of Harvest Energy Trust. And in August, the firm was tapped by Japan's largest trading company, Mitsubishi Corporation, in its $500 million joint venture deal to develop shale gas with Penn West Energy Trust. Meanwhile, MacLeod Dixon, the most truly international Calgary firm, with lawyers in places like Caracas; Moscow; Almaty, Kazakhstan; and Rio de Janeiro, has recently been retained by a number of Indian bidders on Canadian assets, according to lawyers knowledgeable about those transactions.

Why haven't the Calgary firms gotten the Chinese deals work? "The Chinese are a lot about appearances," says a Calgary lawyer. "They will initially look to the international firms rather than the Calgary firms." That will change. Inevitably, Chinese negotiators will become familiar with the lawyers on the other side of the table. "This is just the first chapter," says MacLeod Dixon oil and gas partner Robert Engbloom.

And in a legal world where there are fewer than a dozen firms with broad experience in both energy and capital markets work, bidding by multiple companies on assets will inevitably push some Chinese companies into the arms of new counsel. "There are a limited number of top-floor firms in Canada, so when you're doing a complicated deal with a lot of aspects, you quickly run out of options," notes Dewey & LeBoeuf's McCaw. "They get conflicted out."

Osler, Stikeman, and Blakes may have a head start, but they're going to have to work hard to keep it.

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