AS FOREIGN INVESTMENT LEAVES, CANADIAN OWNERSHIP GROWS

For the past 70 years, there has been substantial foreign investment in Canadian upstream oil and gas. In part, this is because only 20 per cent of the world's oil reserves are open to private development and half of those reserves are in Canada.

But foreign investment in the industry has come and gone over the years with the ebbs and flows of economic nationalism and – more recently – uncompetitiveness of investments in Canadian oil and gas, compared to opportunities elsewhere.

Restrictions on Foreign Investment

Canada has historically welcomed foreign investment, with two notable exceptions. The first was the measures taken after the rapid escalation of foreign ownership of Canadian businesses in the 60s, including in the oil and gas industry, which had become American-controlled following decades of foreign investment with no federal government review. In response, the *Foreign Investment Review Act (FIRA)* was passed in 1973, aimed at restricting foreign investment in Canada. As part of the program to counter the growth of foreign ownership of Canada's oil and gas industry, PetroCanada was created in 1975 and the National Energy Program (NEP) was introduced in 1980. These and other measures were successful in increasing the levels of Canadian ownership in the oil and gas industry.

When opposition to foreign investment subsided in the 1980s, steps were taken to attract investors back into the Canadian oil and gas industry, including replacing *FIRA* with the *Investment Canada Act (ICA)* in 1985, which streamlined the foreign investment review process, eliminating the NEP and restrictions on foreigners acquiring oil and gas companies and ultimately privatizing PetroCanada.

These changes cleared the path for a new wave of foreign investment in the Canadian oil and gas industry, particularly by state-owned enterprises (SOEs). From 2000 to 2012, billions were spent on acquisitions of Canadian oil and gas companies by SOEs from China (CNOOC, PetroChina, Sinopec, China Investment Corp), Abu Dhabi (TAQA), Norway (Statoil), Thailand (PTT Exploration), Korea (Korean National Oil) and Malaysia (Petronas). Frequently, the targets owned Canadian oilsands projects. This acquisition binge climaxed in 2012 with Petronas's $5.5B purchase of Progress Energy and CNOOC's $15.1B purchase of Nexen.

However, the magnitude of oilsands businesses acquired by SOEs during this period caused the Canadian government to conclude (after approving the CNOOC/Nexen transaction in December 2012) that SOEs' control of oilsands development had reached the point where further acquisitions of control would only be allowed in exceptional circumstances. This resulted in the second notable restriction on foreign investment, being the changes to the SOE Guidelines to limit further oilsands acquisitions and to impose other restrictions on SOEs' Canadian M&A activities.

Foreign Investment Declines

Since those changes to the SOE Guidelines, no significant acquisitions of oilsands or other Canadian upstream oil and gas properties by foreign entities, including SOEs, have occurred, except Repsol's acquisition of Talisman in 2015 and for assets sold together with interests in proposed LNG export projects.

Further, new capital investment by existing foreign investors on proposed oilsands projects was deferred or cancelled after oil prices collapsed in 2015 and, in July of this year, Petronas and the other sponsors of the Pacific NorthWest LNG export complex cancelled that project.

Foreign Capital Exits

More importantly, substantial amounts of foreign capital started to exit the Canadian oil and gas industry beginning in 2016. International oil companies, including ConocoPhillips and Murphy Oil (US), Mitsubishi (Japan), Shell (Netherlands), Statoil (Norway) and Harvest (Korea), sold significant parts of their Canadian oil and gas investments to Canadian companies.

The exodus accelerated in the first half of 2017, with ConocoPhillips selling oilsands and other assets to Cenovus for $17.7B, and Shell and Marathon (US) selling oilsands assets to Canadian Natural Resources for $12.7B. Other recent foreign sellers include Apache (US) and Centrica (UK).

These sales have been driven by international oil companies redeploying their capital to more profitable opportunities elsewhere. Canada's environmental and fiscal regimes, high cost of labour and materials, and difficulties in executing export projects were likely among the factors considered in the decisions to sell those properties.

Canadian Ownership Increases

One result of this latest reversal of foreign investment is the significant increase in Canadian ownership of resources, particularly in the oilsands. TD Securities estimated that Canadian control of the country's oil (conventional and oilsands) and natural gas production has grown to 84 per cent and 71 per cent, respectively, with Canadian control of producing oilsands assets increasing to 82 per cent from 67 per cent.

Still, some parts of the Canadian energy sector could attract foreign capital, particularly the Montney shale gas play. The challenge for Canada will be to implement changes that will make opportunities in our energy sector attractive again to foreign and domestic investors alike.

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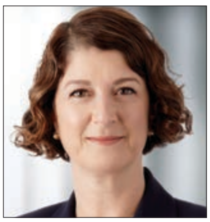

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