

# TORYS

## Canadian LNG:

## Issues and Strategies for Foreign Investors

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This presentation will address:

- Impact of new technology on Canada's oil and gas industry
- Transition from need to import to need to export energy (and need for foreign capital)
- Overview of current projects and foreign investment in these projects
- Structuring foreign investment in projects
  - Finding good JV partners
  - Determining JV structure
- Investment Canada approval of foreign investment
- Challenges impacting Canadian LNG projects/foreign investors

# Development of large unconventional gas plays (using new technology)

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- Throughout the early to mid-2000's, concerns over decreasing conventional supplies of domestic natural gas led to bullish predictions about future LNG demand in North America, resulting in an investment boom to build new LNG import facilities.
- Around 2008, dramatic changes in the market on account of surging U.S. unconventional natural gas production (mostly from shale gas) started to change the outlook for LNG imports. Natural gas production increased, North American prices fell significantly, and the expected need for imported LNG was dampened.

# Transition from need to import to export, and the need for foreign capital

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- The U.S. is becoming increasingly self-sufficient with respect to natural gas. Pipeline exports from Canada to the U.S. are decreasing.
- Industry is shifting its focus from importing LNG into North America to exporting LNG from North America.
- The export of LNG could facilitate Canadian natural gas production growth and result in significant investment, jobs and economic growth.
- An opportunity for Canada to capitalize on its LNG export potential. The Government of Canada is working closely with British Columbia and other provinces to create conditions supporting the development of an LNG industry in Canada and favourable conditions to attract foreign investors.

# Overview of current projects and foreign investment in these projects

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- As at September 2014, the following are the proposed LNG export terminals in Canada:
  - Douglas Channel LNG, Kitimat, BC
  - Kitimat LNG, Kitimat, BC
  - LNG Canada , Kitimat, BC
  - Pacific Northwest LNG, Prince Rupert, BC
  - Prince Rupert LNG, Prince Rupert, BC
  - Goldboro LNG, Guysborough County, NS
  - Woodfibre LNG, Squamish, BC
  - WCC LNG, Kitimat or Prince Rupert, BC
  - Triton LNG, Kitimat or Prince Rupert, BC
  - Aurora LNG, Prince Rupert, BC
  - Kitsault Energy Project, BC
  - WesPac Marine Terminal, Delta, BC
  - Steelhead LNG, TBD, BC
  - Grassy Point LNG, Prince Rupert, BC
  - Discovery LNG, Campbell River, BC
  - Cedar LNG, Kitimat, BC
  - Orca LNG, Prince Rupert, BC

# Structuring foreign investment in Canadian LNG projects

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- For the past two years, there has been a steep decline in M&A activity in Canada's oil and gas sector.
- Nothing has matched the marquee deals of 2012 (Petronas acquisition of Progress Energy or CNOOC / Nexen deal).
- Foreign investment into LNG and other major oil and gas projects has often been in some form of joint venture, for example:
  - Kitimat LNG (Chevron and Apache)
  - LNG Canada (Shell, KOGAS, Mitsubishi and PetroChina)

# Structuring foreign investment in Canadian LNG projects

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- There are a lot of joint ventures in the works.
- Producers can reduce exposure/risks and require capital to reduce. Investors taking minority interests have less regulatory risks.
- Foreign investors can gain knowledge and experience from participating in unconventional plays.
- But “marriages” with the wrong partner can be problematic. Need alignment on how to develop project.
- Typical issues include governance and deadlock, default (buyout, etc.), IP, transfer restrictions and secondment of employees.

- **Management Support**
  - Full support and commitment
  - Goals and objectives compatible and aligned
- **Mutual Trust**
  - Reliable in fulfilling obligations
  - Increase in information exchange and joint problem solving
- **Long Term Commitment**
  - Willingness to exert effort and weather unanticipated problems
  - Balance of short-term objectives with long-term goals
- **Management Skills**
  - Effective communication
  - Creativity to encourage innovative work
  - Constructive approach to conflict resolution



- Critical to consider various factors prior to selecting structure:
  - Regulatory
  - Financial
  - Governance
  - Liability
  - Tax
  - Other factors (e.g. goals re project development, future partners?)

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- **Basic Options:**

- *Joint Venture (unincorporated):*
  - Contractual relationships with no separate legal entity
  - Typically, a joint ownership and operating agreement
  - Eliminating cost/administrative burdens of creating and managing a separate entity
- *Joint Venture (incorporated):*
  - Create separate legal entity owned by joint venturers
  - Profits distributed in proportion to share ownership
  - Limited liability of shareholders
  - A shareholders' agreement

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- **Basic Options: (continued)**

- *General Partnership:*

- Partners contribute assets to the partnership
- Partners have joint ownership and control
- Partnership profits distributed per partnership agreement
- Joint and several liability for obligations of partnership

- *Limited Partnerships:*

- Created by statute having general and limited partners
- General Partner has unlimited liability for obligations of the LP
- Limited Partner's liability limited to contributed capital
- Limited Partners can be characterized as general partners with liability consequences

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- It is important to consider the appropriate structure only after consulting with various stakeholders (finance, tax, regulatory, etc.).
  - Major energy projects are being successfully managed using various structures.

- A direct acquisition of control of a Canadian business by a non-Canadian is generally subject to review if:
  - The worldwide book value of the Canadian business exceeds C\$352 million
  - Median review times are 70 days but reviews of high-profile investments and investments by state-owned enterprises (SOEs) are longer

- The focus of the “net benefit” test is on the impact to the Canadian business on matters such as employment, capital expenditures and other investments in Canada, head office location and stock exchange listing.
- Investors typically must give 3, 5 or 10 year undertakings, while some undertakings are for the period of time that an investor owns the Canadian business.

# Investment Canada Act – Overview

## National Security Review

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- An investment may also be reviewed on “national security” grounds.
- Two high profile telecom investments have failed the “national security” review recently (Wind Mobile Canada and Telecom’s Allstream Division).
- The risk assessment will depend on the identity of the buyer, the business operations of the Canadian target and the degree of control being acquired.
- “national security” is not defined but would include assets with military or strategic significance and critical infrastructure, especially in telecoms.
- The review process is not transparent and can be long.

- It is extremely rare for transactions to be blocked - only three (out of over 1600) have been blocked on “net benefit” grounds in the last 25 years.
- A small number of transactions will continue to draw attention, such as those with SOE or sovereign wealth funds as acquirors; targets with special relevance to certain provinces; and high-profile “national champion” targets.



- Wise to announce robust “net benefit” plans at the outset of a review process, such as:
  - Listing foreign parent on the TSX or listing the Canadian business on the TSX (CNOOC/Nexen)
  - Expanding Canadian head office responsibilities (CNOOC)
  - Involving Canadians in the acquisition (Agrium, RIL in Glencore/Viterra)
  - Putting Canadians on the board of the global parent (Rio Tinto/Alcan) or putting Canadians on the board of the Canadian subsidiary (common)
  - Avoid hostile transactions

- Avoid acquisitions of control as defined in the Act, such as SOE investments in oil sands and other potentially controversial investments.
- Despite the concerns for the government's Guidelines, note that several state-owned acquisitions of control have been approved since the CNOOC / Nexen approval was issued:
  - CQ Energy Canada Partnership in 2013
  - In May 2014, the Minister of Industry issued a net benefit approval for PTTEP's acquisition of control of three oil sands projects from Statoil Canada. PTTEP is a Thai state-owned enterprise for purposes of the Investment Canada Act

- Throughout most of Canada, the Crown has entered into treaties with indigenous peoples whereby those peoples gave up their claim to land in exchange for reservations and other promises. Recently, the Supreme Court of Canada (SCC) released its unanimous decision in *Tsilhqot'in Nation v. British Columbia*.
- This decision marks the first time the SCC has upheld a specific Aboriginal title claim. The SCC also provided greater clarity on the question of when and to what degree provincial laws apply to Aboriginal title lands.

- The *Tsilhqot'in Nation* decision is expected to have significant, but variable, implications for infrastructure and energy projects across Canada, depending on the geographic area at issue in a specific project:
  - If a project involves lands where Aboriginal treaties clearly extinguish Aboriginal title rights, this decision will likely not change the applicable law
  - If a project involves lands where existing Aboriginal treaties do not clearly extinguish Aboriginal title rights, this decision will apply to future Aboriginal title claims
  - Similarly, if a project involves lands whose Aboriginal peoples never entered into treaties with the Crown, as was the situation in this case, this precedent applies

# Challenges surrounding Canadian LNG projects – Aboriginal Issues... *cont'd*

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- The law governing potential Aboriginal title claims depends on the existence and wording of Aboriginal treaties as well as the specific historical and other facts giving rise to the title claim in each particular case.
- Before Aboriginal title is established by treaty or court order, the Crown is subject to a duty to consult and potentially accommodate Aboriginal interests. This decision does not change the legal framework applicable to lands subject to unproven Aboriginal title claims.
- The degree of consultation or accommodation required depends on the strength of the Aboriginal title claim and the severity of potential adverse impacts of the project.

- However, once Aboriginal title has been established, the Crown must either obtain consent from the Aboriginal titleholder, or satisfy a stringent public interest analysis to justify the incursion on Aboriginal title.
- The SCC confirmed that proposals to use or exploit land, before or after Aboriginal title is recognized, can avoid allegations of infringement or failure to adequately consult by obtaining the consent of any interested Aboriginal groups.

# Challenges surrounding Canadian LNG projects – other challenges

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- There are at least 14 B.C. LNG projects planned, but unclear how many will proceed. No final investment decisions have been made yet to build LNG projects on Canada's Asia-facing West Coast.
- Environmental assessments, lack of infrastructure and complicated negotiations with First Nations are challenging.
- As global demand for LNG continues to increase, so does global supply, with projected exports post-2015 coming from Equatorial Guinea, Australia, Indonesia, Russia, Canada and possibly the United States. With greater competition in the global export market, demand for Canada's LNG is at risk of decreasing. Australia in particular poses a potential and significant challenge with dramatic increases forecast in their production of LNG well before Canadian companies can get their gas liquefied. Potential impact on pricing.

# Challenges surrounding Canadian LNG projects – other challenges... *cont'd*

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- LNG projects require massive levels of investment and each delay increases the likelihood of being squeezed out due to increased global gas supplies scheduled for 2018 and 2019. Companies will be facing pressure to make final investment decisions or miss the chance to export B.C. LNG.
- Industry experts say there will be pressure for B.C. LNG projects to consolidate.
- Industry resistance to B.C. proposed tax regime for LNG. “Negotiations” ongoing.
- Large energy projects leading to increasing costs and labour shortages.



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