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China national offshore oil corporation: operations in canada[[1]](#endnote-1)

Xiaoyu Liu, Hao Lu, Loren Falkenberg, and Harrie Vredenburg wrote this case solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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In June 2016, China National Offshore Oil Corporation (CNOOC) announced the replacement of its president and chief executive officer (CEO).[[2]](#endnote-2) The replacement took place when the world oil price was at the same low level it had been since February 2016—the price of oil had fallen continuously, dropping from US$115[[3]](#endnote-3) per barrel in June 2014 to less than $35 per barrel in February 2016.[[4]](#endnote-4)

CNOOC started investing in Canada in April 2005, when the price of oil was around $50 per barrel, acquiring 16.69 per cent equity of MEG Energy Corp. (an energy company headquartered in Calgary, Alberta).[[5]](#endnote-5) In November 2011, CNOOC made its second Canadian acquisition and bought OPTI Canada (OPTI), a Canadian oil company that had filed for bankruptcy for CA$2.04 billion when the price of oil was around $105 per barrel.[[6]](#endnote-6) In February 2013, when oil was around $107 per barrel, CNOOC completed the contentious acquisition of Nexen Inc. (Nexen), a Canadian oil and gas company, for $15.1 billion. In 2017, more than three years after the acquisition, faced with severe challenges associated with low oil prices, the Nexen deal seemed to have become a “tough swallow” for CNOOC.[[7]](#endnote-7) What was the Canadian market situation, given the low oil price? How could CNOOC respond to the challenges associated with the low oil price? How should CNOOC adjust its business strategies?

china national offshore oil corporation (CNOOC)

Company Overview

CNOOC was a state-owned company supervised and controlled by the State-Owned Assets Supervision and Administration Commission of the State Council of China. CNOOC was founded in 1982 and was the third-largest national oil company in China. In 2015, the company’s total assets were $96.06 billion and it had 100,821 employees. Two subsidiaries of CNOOC—CNOOC Limited and China Oilfield Services—were listed on the Hong Kong stock exchange. CNOOC engaged in a wide range of businesses in the energy industry, including crude oil and natural gas exploration and marketing, natural gas and power generation and marketing, petrochemicals refining, new energy development, financial services, and some professional services related to the oil industry.[[8]](#endnote-8)

History of International Expansion

Although CNOOC was smaller than the other two state-owned oil companies in China (China National Petroleum Corporation and China Petroleum Chemical Corporation), it had grown quickly through its aggressive international expansion. In the 1990s, CNOOC started its overseas expansion through direct investments and acquisitions. Asia (including Indonesia and Iraq) was the first overseas region CNOOC had expanded into. CNOOC also had a large oil and gas reserve and many production operations in Africa, including in Nigeria, Uganda, Equatorial Guinea, the Republic of the Congo, Algeria, and Gabon. CNOOC also operated in South American countries, including Argentina, Brazil, and Colombia. In Oceania, CNOOC operated in Australia, Papua New Guinea, and New Zealand. CNOOC’s assets in Europe included the United Kingdom, the Norwegian Sea, and Northeast Iceland. Since 2005, North America had represented the biggest overseas reserves and production region for CNOOC. As of June 2016, CNOOC was operating in several regions in more than 15 countries (see Exhibit 1).[[9]](#endnote-9)

In December 2015, CNOOC’s net proved reserves were estimated to be 4.32 billion barrels of oil equivalent (BOE), and its average net production was 1,358,022 BOE per day, which represented an increase of 33 per cent since 2010.[[10]](#endnote-10) However, due to low oil prices, CNOOC’s revenue in 2016 dropped 14.55 per cent from its revenue in 2015 (see Exhibit 2).[[11]](#endnote-11)

EXPANSION IN CANADA

With the fast development and promising future of the Canadian oil sands industry, CNOOC started to invest in Canada in 2005 in an effort to diversify its investment projects and secure more energy to fuel the rapid development of the Chinese economy.[[12]](#endnote-12) CNOOC believed that investing in the Canadian oil sands represented an opportunity for the company’s sustainable growth.

Rise of the Canadian Oil Sands Industry

Oil sands could be found in several locations around the globe, including Venezuela, the United States, Canada, and Russia. The largest deposit was the Athabasca deposit in Alberta, Canada. Alberta’s proven oil reserves were 175.3 billion barrels (including 173.7 billion barrels of bitumen reserves), the second-largest oil reserves on the planet.[[13]](#endnote-13) In 1967, Suncor Energy Inc. (formerly the Great Canadian Oil Sands project) was the first company to develop operations in the Fort McMurray oil sands. However, for many decades, the development of the Athabasca deposit was not as fast as expected due to the high technological requirements and financial input needed for extraction.[[14]](#endnote-14)

When the price of oil was high, engineers and scientists had incentives to develop innovative ways to extract from the oil sands the heavy oil and bitumen that previously could not be produced.[[15]](#endnote-15) With an increase in the global price of oil in the late 1990s (see Exhibit 3), the oil sands industry began to expand rapidly. Exhibit 4 shows bitumen production from unconventional oil sands in Canada between 1994 and 2015. As shown, oil production increased from 0.305 million barrels a day in 1998 to 1.06 million barrels a day in 2005; meanwhile, annual capital expenditure increased by almost 700 per cent from CA$1.5 billion in 1998 to CA$10.4 billion in 2005.[[16]](#endnote-16) Alberta achieved non-renewable resource revenue of CA$14.3 billion in 2006, a record high for Canada.[[17]](#endnote-17)

The price of oil increased steadily between 2006 and 2013, thus more investments were put into oil sands projects. In February 2013, crude oil was $107.66 per barrel. The price then stayed constant, indicating a promising future for oil in 2014.

CNOOC’s Three Major Investments in the Canadian Oil Sands Industry

CNOOC expanded into the Canadian oil sands industry in 2005 and invested in three major projects: MEG Energy Corp., OPTI Canada, and Nexen Inc.

**MEG Energy Corp.**

CNOOC’s first investment in Alberta was the purchase of a 16.69 per cent equity share of MEG Energy Corp. for CA$150 million in April 2005. MEG Energy Corp. was a Calgary-based oil sands company that owned a 100 per cent working interest of nearly 33,000 acres (13,355 hectares) in Alberta oil sands. The total estimated reserve was more than 4 billion barrels of bitumen, which would yield recoverable reserves of approximately 2 billion barrels.[[18]](#endnote-18) At the time, MEG Energy Corp. was listed on the Toronto Stock Exchange.

This project was implemented through CNOOC Belgium BVBA, a subsidiary of CNOOC. After the acquisition, the chief financial officer and senior vice-president of CNOOC commented, “I am excited with our low cost entry into oil sands, gaining a footstep in this potential area. Lower operating costs and higher recoveries resulting from recent advances in technologies have made many similar projects economically viable.” From this acquisition, CNOOC expected to acquire advanced technology and use it to facilitate the extraction and development of shale oil in China.[[19]](#endnote-19)

**OPTI Canada**

CNOOC’s second operations project in the Canadian oil sands industry was the acquisition of OPTI Canada (OPTI) for CA$2.04 billion in November 2011.[[20]](#endnote-20) OPTI was a Calgary-based oil sands development company. Established in 1999, OPTI had only one project: it owned 35 per cent of the Long Lake oil sands project; the remaining 65 per cent was owned by Nexen as the project operator.

The stock price of OPTI had hit a breaking point in late 2010 and continued falling. In early 2011, OPTI faced severe liquidity problems and struggled with its $2.8 billion debt. After OPTI filed for bankruptcy protection in July 2011, CNOOC announced its acquisition of OPTI through its indirectly owned subsidiary, CNOOC Luxembourg S.à r.l.[[21]](#endnote-21)

The acquisition was believed to mutually benefit both partners. Chris Slubicki, the president and CEO of OPTI at the time, said, “CNOOC Ltd. is a technically experienced and well-capitalized company that is equipped to support further development at Long Lake and future expansions in the Canadian oil sands.”[[22]](#endnote-22) The CEO of CNOOC mentioned that such an acquisition would ensure production growth in the long term for CNOOC.[[23]](#endnote-23)

**Nexen Inc.**

Nexen Inc. (Nexen) was an energy company that conducted business in Canada, the United States, the United Kingdom, and Africa. Its main operation was in upstream oil and gas extraction. Nexen became Canadian Occidental Petroleum Ltd. in 1969, with an 80 per cent equity share owned by Los Angeles-based Occidental Petroleum. In February 2013, CNOOC acquired Nexen for $15.1 billion. With the completion of the acquisition, Nexen became one of CNOOC’s wholly owned subsidiaries. Through Nexen, CNOOC owned 100 per cent of the Long Lake oil sand project’s working interest and held leases for three other oil sands projects in Athabasca. CNOOC indicated that it would keep all current Nexen employees as well as its management team.[[24]](#endnote-24)

The takeover price was $27.50 per share, with a premium of 61 per cent to Nexen’s closing price on July 20, 2012.[[25]](#endnote-25) The acquisition of Nexen was therefore labelled as contentious by the media—the deal was a high-cost takeover and represented China’s largest foreign corporate acquisition. After the acquisition, the Canadian government announced that it would no longer allow a state-owned company to own a majority interest in any petroleum projects.[[26]](#endnote-26)

Challenges in the Operating Environment

**Oil Price**

In September 2014, the price of crude oil began to experience a continuous decline (see Exhibit 3). In January 2016, the price hit a historical low: $29.92 per barrel. The depressed oil and gas prices hindered the development of the Canadian oil sands industry, and the limited market created many challenges for CNOOC’s operations.

To cope with the collapse in crude oil prices, CNOOC shut down Nexen’s Calgary-based oil-trading operation in March 2015, indicating it would be cutting 100 jobs. A spokesman for the Alberta government, Chris Bourdeau, expressed his surprise at the shutdown: “They have been a Crown agent since 2007 and the relationship has been good.”[[27]](#endnote-27)

In June 2016, CNOOC announced the immediate replacement of its president and CEO, Fanrong Li, who had led the company through the acquisition of Calgary-based Nexen. His replacement as president was Yuan Guangyu, and his replacement as CEO was Yang Hua. A new compliance officer was also appointed. With the change in its top management team, CNOOC was aiming to tackle the challenges of low oil prices and to adjust corporate strategies for business development in the Canadian oil sands industry.[[28]](#endnote-28)

Competition in the Canadian Oil Sands Industry

The Canadian oil sands industry was highly competitive. Major multinational enterprises (MNEs), such as Exxon Mobil Corporation, ConocoPhillips Company, and BP plc, dominated the industry and had competitive advantages in terms of operation management and technology. CNOOC was almost a century later than these MNEs in its exploration in this industry.[[29]](#endnote-29) Compared with these companies, CNOOC was facing an unfavourable competitive environment because it had fewer capabilities and less knowledge of the local market. In addition to these MNEs, quite a few local energy companies competed in the Canadian oil sands industry, including Enbridge Inc., Suncor Energy Inc., Encana Corporation, and Enerplus Corp. Compared with MNEs (including CNOOC), these local companies had more knowledge of the local market and Canadian institutions, and had more support from the local government.

Despite the companies operating within the industry, the Canadian oil sands industry had two major product competitors: conventional oil produced mainly in the Middle East and shale oil produced mainly in the United States. The production costs for projects in the Middle East and Northern Africa were around CA$20 per barrel. Worldwide, the typical cost of conventional oil was between $30 and $40 per barrel. The break-even point of shale oil wells varied from $40 to $90 per barrel. Oil shale was a layer of rock that contained particles of kerogen that were used to produce oil. The petroleum products could be extracted in two ways: (1) mining the rock and melting the kerogen into oil using heat above ground, and (2) heating the kerogen to produce oil and gas underground, and extracting the oil from the shale.

Government Regulations

The Canadian oil sands industry was under harsh international scrutiny for the way it managed the development of the oil sands. Canadian environmental laws were thus stricter than those of China and other developing countries. The Canadian Environmental Assessment Agency (CEAA) acted as a central hub to coordinate the regulatory bodies with regards to oil sands development proposals. Each province had its own set of environmental laws with which companies had to comply.

In Alberta, two organizations regulated the oil sands facilities: the provincial government’s Environment and Parks department (which set the provincial policy) and the Alberta Energy Regulator (AER) (which ensured the policy was applied). Also, Alberta’s Land-Use Framework was developing regional plans to safeguard air and water quality in any given region, such as the Lower Athabasca Regional Plan.[[30]](#endnote-30) Before any project commenced, oil sands operators needed to file an application for provincial review with AER, and some projects were also subject to a federal review with the CEAA.

Environmental Non-Governmental Organizations

Environmental non-governmental organizations (NGOs) put a great deal of pressure on the oil sands industry in terms of development. For example, Greenpeace Canada (an environmental NGO) showed great concern about the environmental risks associated with oil sands development. It reached out to landowners and First Nations affected by the oil sands to stand in solidarity with Greenpeace Canada and amplify its voice. It developed a comprehensive strategy for energy revolution in Canada and called for a clean energy future. In July 2015, one of Nexen’s pipelines in the Long Lake facility leaked approximately five million litres of an oil sand and wastewater mixture into the local community. Greenpeace Canada criticized this incident as a reminder of Alberta’s pipeline problems, which required constant attention.[[31]](#endnote-31) CNOOC would need to develop corresponding environmental strategies to address the criticism from these environmental NGOs.

Employee Safety

Safety was key to companies in the oil sands industry. In January 2016, an explosion in Nexen’s Long Lake plant killed two workers. It did not take long for Nexen to get the fire under control and extinguish it. Later, Nexen revealed that the major causes of the pipeline rupture were poor design and undetected mechanical problems. As indicated by Nexen’s chief executives, “When we fail to live up to our high standards of safety and environment, we let ourselves, our employees and the communities where we operate down. This is not acceptable.”[[32]](#endnote-32) As Occupational Health and Safety imposed an order banning operations in the explosion area, Nexen ceased operations at the entire upgrader facility where the explosion had happened.

Looking Ahead

In the Canadian oil sands industry, Canadian government regulations and institutions imposed a different and higher standard (compared with that in China) at which CNOOC needed to operate. In a crowded industry with well-established competitors, the extensive market pressure of low oil prices, and higher requirements on corporate social responsibility performance, how could CNOOC find success and maintain the steady development of its operations?

Exhibit 1: China National Offshore Oil Corporation’s MAJOR EXPLORATION AREAS

|  |  |  |
| --- | --- | --- |
|  | **Areas** | **Major Exploration Areas (Net) (km2)** |
| **Offshore China** | Bohai Sea | 43,068 |
| Western South China Sea | 73,388 |
| Eastern South China Sea | 55,424 |
| East China Sea | 85,413 |
| **Subtotal** | **257,292** |
| **Overseas** | Asia (excluding China) | 5,670 |
| Africa | 4,668 |
| Oceania | 25,140 |
| North America | 3,710 |
| South America | 7,505 |
| Europe | 12,979 |
| **Subtotal** | **59,671** |
| **Total** | 316,963 | |

Note: km2 = square kilometres

Source: CNOOC, *2016 Annual Report China National Offshore Oil Corp*., April 21, 2017, accessed May 12, 2017, www.cnooc.com.cn/attach/0/1706141400351842136.pdf.

Exhibit 2: china national offshore oil corporation’s KEY FINANCIAL INDICATORS, 2006–2016 (in ¥ millions)

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **2016** | **2015** | **2014** | **2013** | **2012** | **2011** | **2010** | **2009** | **2008** | **2007** | **2006** |
| **Total Revenues** | 146,490 | 171,437 | 274,634 | 285,857 | 247,627 | 240,944 | 183,053 | 105,195 | 125,977 | 90,724 | 88,947 |
| **Total Expenses** | 148,902 | 153,981 | 193,719 | 207,354 | 160,486 | 150,337 | 111,648 | 64,870 | 72,112 | 49,525 | 45,893 |
| **Investment Income** | 2,774 | 2,398 | 2,684 | 2,611 | 2,392 | 1,828 | 427 | 200 | 476 | 902 | 613 |
| **Profit before Tax** | 5,275 | 17,130 | 82,513 | 80,851 | 90,172 | 92,565 | 72,650 | 40,821 | 57,880 | 43,310 | 44,123 |
| **Current Assets** | 122,045 | 140,211 | 140,708 | 146,552 | 170,894 | 131,923 | 100,653 | 70,871 | 63,770 | 54,645 | 47,892 |
| **Total Assets** | 637,681 | 664,362 | 662,859 | 621,473 | 456,070 | 384,264 | 327,926 | 242,268 | 206,669 | 179,793 | 155,268 |
| **Net Production of Crude in Canada (barrels/day)** | 40,304 | 46,712 | 48,183 | 39,872 | – | – | – | – | – | – | – |
| **Net Production of Natural Gas in Canada (mmcf/day)** | 48.9 | 68.4 | 117.5 | 106.0 | – | – | – | – | – | – | – |
| **Total Net Proved Reserves (million BOE)** | 300.5 | 835.2 | 820.2 | 802.8 | – | – | – | – | – | – | – |

Note: ¥ = CNY = Chinese yuan renminbi; US$1 = ¥6.6550 on June 30, 2016; mmcf = million cubic feet; BOE = barrels of oil equivilant. As Canada’s proved reserves represent over 15 per cent of CNOOC’s total proved reserves since the end of 2013, production data are disclosed separately for Canada for year 2013 and onward. Prior to 2013, Canada’s numbers were included in those for North America (if applicable) or overseas, and were disclosed on a combined basis in CNOOC’s annual reports. Therefore, we have not included the numbers of net production or net reserves of crude oil and natural gas in Canada prior to 2013.

Source: China National Offshore Oil Corporation annual reports from 2006 to 2016.

Exhibit 3: Crude oil prices, 1994–2016 (us$ per barrel)

Source: Adapted from “Average Annual West Texas Intermediate (WTI) Crude Oil Price from 1976 to 2018 (in U.S. dollars per barrel),” Statista, accessed May 14, 2018, www.statista.com/statistics/266659/west-texas-intermediate-oil-prices/.

EXHIBIT 4: BITUMEN PRODUCTION IN CANADIAN OIL SANDS INDUSTRY, 1994–2015

Source: Alberta Government, Ministry of Energy annual reports from 1996 to 2016.

endnotes

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