

National Oil Cos. Shake Up Global Deal-Making Scene

By **Keith Goldberg**

Law360, New York (December 02, 2014, 3:48 PM ET) -- The increasing clout of state-owned oil companies, fueled by their willingness to venture beyond their borders, has increased competition in the global energy deal-making space while adding in geopolitical variables that can make it harder to get deals done, energy attorneys say.

In 2014, state-owned oil companies outnumbered investor-owned companies on Energy Intelligence's list of the top 10 oil and gas concerns in the world for the first time in a decade. Some of the names are familiar, like Saudi Arabia's Saudi Aramco, but also include relative upstarts such as China's China National Petroleum Corp. and Russia's OAO Rosneft and OAO Gazprom.

"It's not a passing phenomenon," said Jay Cuclis, who co-chairs Vinson & Elkins LLP's energy transactions and projects practice group and splits his time between the U.S. and Hong Kong. "You have to expect that all the national oil companies are going to remain major players."

Energy Intelligence's rankings consider several factors, including size of oil and gas reserves and production. In that sense, it's not surprising that state-owned firms like Saudi Aramco and Rosneft, located in oil-rich countries, are among the world's most influential, according to Akin Gump Strauss Hauer & Feld LLP partner Steve Davis

However, China isn't a major oil and gas producer, yet thanks to the country's voracious appetite for energy, companies like CNPC and China Petroleum & Chemical Corp., better known as Sinopec, have become global oil and gas forces.

"What you've seen is many of the consumer national oil companies have gone outside of their boundaries and have begun acquiring oil and gas reserves in other parts of the world, and in that part of their business, they are competing directly with international oil companies, as well as competing with other consumer national oil companies," said Davis, who's worked extensively in Asia and has represented state-owned GAIL (India) Ltd. in securing supplies from Dominion Resources Inc.'s Cove Point liquefied natural gas export project in the U.S.

Even producing state-owned companies like Saudi Aramco are starting to venture outside their borders in order to diversify their operations, attorneys say

"Some are seeking out new resources, some of them are seeking markets, and some of them are seeking

technology,” said Baker Botts LLP partner Jason Bennett, who works on global oil and gas project development. “Aramco is constantly hunting for markets and trying to go downstream.”

The shift abroad has been accompanied by a shift in behavior, with state-owned companies increasingly looking to operate like their investor-owned competitors rather than an arm of their backing governments, attorneys say.

“You’re beginning to see a recognition in some national oil companies that in order to be competitive, they can’t simply be a revenue source, they have to be able to make logical and market-driven investment decisions, and that has not only led to national oil companies making large investments outside their host countries, but also a change in philosophy,” said Mayer Brown LLP partner Thomas Moore, who’s represented both state-owned and investor-owned companies.

That adds up to a more heated pursuit of oil and gas assets around the globe, and more competition for oil and gas supermajors long used to being the biggest kids on the block.

“They’re not the only game in town anymore, because you have a group of state-owned oil companies that are not only technologically sophisticated and have the capital to invest, they have intangibles that investor-owned companies don’t,” Moore said.

Those intangibles including having extremely deep pockets and no public shareholders to satisfy, as well as a different set of priorities than investor-owned companies.

“The state-owned companies are probably willing to take more legal and political risk, particularly in the emerging markets,” Cuclis said. “They may have higher priorities on securing significant reserves of oil and gas.”

Chinese state-owned oil companies, for example, have sunk billions into securing oil and gas reserves in all corners of the world, stable and unstable. Meanwhile, many investor-owned companies, especially U.S.-based independents, have scaled back their foreign operations to focus more on domestic development that may be just as lucrative, but more stable.

But the global clout of state-owned oil companies extends beyond simply an ability to write big checks. It’s the ability to leverage the power of a sovereign government, whether through the formation of export credit agencies to finance international acquisitions or projects, or inking broad trade and development deals with countries that hold significant oil and gas reserves.

Moore says that’s been especially apparent in Africa, where Chinese state-owned firms have grabbed a significant piece of oil and gas interests in countries like Angola in part due to the billions the Chinese government has sunk into overall economic development.

“It’s been able to link government-to-government support in a way that’s simply impossible for a supermajor,” Moore said. “Where that leaves the classic investor-owned oil company: It still has an advantage in making technology available and ... significant capital resources to make available, but it has to compete with someone on what is becoming an increasingly unlevel playing field.”

Still, investor-owned oil companies, especially the supermajors, have decades-long head starts on many state-owned firms when it comes to devising ways to effectively and profitably pull oil and gas out of the ground.

"The international oil companies have a long track record of developing large, complicated oil and gas projects and that is an area where many consumer national oil companies are still catching up," Davis said. "That skill set is a very valuable skill set and one the international oil companies justifiably play up."

That's one reason why you're increasingly seeing joint venture agreements between investor-owned and nationally owned oil companies, both abroad and in their home countries, attorneys say. One example is Rosneft, which inked a deal with ExxonMobil Corp. to jointly drill for oil in the Russian Arctic, hoping to tap the offshore, deepwater expertise of the world's largest supermajor.

"The national oil companies now control a vast percentage of the oil and gas reserves in the world. The international oil companies are increasingly going to have to demonstrate how they give the national oil companies something they don't have," Cuclis said. "More and more, the international oil companies are going to have to find ways to distinguish themselves in areas that the national oil companies can't just go out and buy using an oilfield service company."

But making a deal with a state-owned company, whether it's selling assets or forming a JV, carries its own set of complexities rarely seen in arm's length negotiations between private companies, attorneys say.

No matter how much a state-owned company asserts its independence in its operations, it's still part of a sovereign government, which adds potential political obstacles to getting a deal done in the form of a stricter approval process by countries affected by the deal.

"They're quasi-governmental entities that have to consider how this deal puts them in the jurisdiction of the country and the impact of those laws," Bennett said. "It's not just tax planning and the like."

For example, state-owned companies eager to tap the shale-rich U.S. may have to first get through the Committee on Foreign Investment in the U.S. And if a company wants to make a deal with Rosneft and Gazprom, it has to work around increasingly restrictive sanctions imposed on the Russian energy sector in the wake of the crisis in the Ukraine — ExxonMobil has already hit the pause button on its Arctic work with Rosneft.

And there's this simple fact: Governments change, and a new government could decide to steer its oil company in a completely new direction.

State-owned companies "aren't driven by shareholders' demands and capital budgets," Bennett said. "They can be affected by changes in strategic policies of their home country."

--Editing by John Quinn and Mark Lebetkin.