



**National security, national interest and natural resources:
What should Canadians think about CNOOC's bid for Nexen?**

Wednesday, October 17, 2012 – Ottawa ON

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Given the shortness of time, I'd like to highlight just three themes associated with the Nexen transaction and the broader questions raised by rapidly expanding Chinese investment and ownership stakes in Canada's energy, telecommunications and other sectors. Prior to doing so, however, I wish to point out that I'm cognizant of the business and financial dimensions of this transaction, having served as a Vice President in the International Department of the Chase Manhattan bank for a number of years with responsibility for Chase's loan portfolios in the former Soviet Union, Central and Eastern Europe and then-Yugoslavia. Make no mistake, this is a "sovereign risk" deal, quite similar to those I dealt with as an international banker.

That said, the three main questions are:

- First, what levels of Chinese government "ownership," or other types of stakes, in Canada's energy sector are economically and commercially beneficial, yet still prudent from a national security perspective?
- Second, has there been an established tradition in Canada, and adequate intra-Ministerial coordination, regarding the performance of security-minded due diligence with respect to large natural resource and other commercial ventures with China and other authoritarian governments?
- Third, has there been ample national security-oriented review of the risk profiles and record of global activities – some of them with troubling geopolitical implications – of three Chinese entities with a sizable presence in Canada, namely Sinopec, CNOOC and Huawei?

The first of these questions is the one we're grappling with today, striking a proper balance between economic benefit and national security concerns. The second deals with



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whether there exists an organizational structure within the Canadian government that drives the integration of commercial and security-related considerations. With respect to this latter issue, it may be helpful to review briefly how we accomplished this task at the Reagan White House in the early 1980s when I served as Senior Director of International Economic Affairs at the National Security Council and Executive Secretary of a Cabinet-level body we called the Senior Interdepartmental Group – International Economic Policy (or the SIG-IEP).

This interagency group included all of the relevant economic and commercial agencies of the Executive Branch (e.g., Treasury, Commerce, USTR, OMB, Energy, etc.) as well as State, Defense, NSC and CIA. While the group was nominally Chaired by the Secretary of the Treasury, it reported through the National Security Advisor to the President. This meant that the decision memoranda to the President on an issue, like the Nexen investment, which outlined the various agency positions and policy options, was drafted by my office and often carried a final recommendation for the President. No other government agency was able to view these decision memoranda. After the President made his decision, we at NSC also drafted the so-called National Security Decision Directives, which communicated the President's final decision and how it was to be implemented. The question before us today is: Does Industry Canada, the government Department reportedly charged with implementation of the Investment Canada Act, have an established mechanism in place to ensure that the views of the Canadian security community are properly tabled, integrated and reviewed?

While on the subject of the Reagan years, there's another "case study" that I believe is relevant to the current assessment of the Nexen deal. That is the occasion when President Reagan dug in his heels concerning the huge, twin-strand Siberian gas pipeline project (an estimated \$35 billion deal and the largest in East-West economic history) – against the backdrop of Soviet-sponsored Marshal Law in Poland. In short, the President demonstrated the political will to catalyze the most serious dispute in the modern history of the Atlantic Alliance over a proposition that had never been tested nor had any precedent.

That proposition was that if Western Europe became over 65% dependent on Soviet natural gas (with the full subscription of both pipelines) – and 100% dependent in the case of several European countries – would the Kremlin eventually use that dependency as an economic warfare tool against the heart of NATO? Our answer was "yes," and events have since repeatedly affirmed the wisdom and validity of what seemed to most observers at the time to be an alarmist, unfounded prediction. Today, the expression "pipeline politics" is generally accepted. Then, it didn't exist in mainstream, or even peripheral, national security deliberations.



To cut to the proverbial chase:

- at a time of an ascendant PLA that is more frequently complicating or preempting civilian decision-making in China;
- at a time when CNOOC's Chairman, Wang Yilin, declared publicly that his firm's large-scale, deep-water rigs are a "strategic weapon;"
- at a time when China has already used a debilitating rare earth embargo to penalize Japan for a paltry incident in the East China Sea;
- at a time when China is establishing a "Department of International Economy" under the auspices of the Foreign Ministry designed to facilitate a more coercive economic approach to achieve the country's strategic objectives...

...does this appear to be an appropriate moment for Canada to simply cross its fingers, take the plunge on the Nexen deal as currently configured and hope for the best? I don't think so.

As there are but a few minutes remaining, I'd like to get quickly to some of the "bottom lines" concerning this transaction, and those involving other large Chinese entities in Canada. Chinese state-owned enterprises, including some of those which purport to be "independent" like Huawei, are often somewhat "colorful" from a national security perspective. They are generally "multi-tasked" by Chinese leadership, which includes almost certain primacy for the military, as needed.

As China establishes a greater presence in the global capital markets, foreign government procurement opportunities, and large-scale investments in "national assets" like those of Canada, Beijing, and the enterprises themselves, are actively seeking to sanitize the big SOEs to advance purposes such as the current Nexen deal (witness Huawei's huge PR expenditures). However, the supposed SOE firewall between commercial and military/strategic priorities is simply not real or sustainable. It will likely be breached because of the multi-layered missions of those SOEs, particularly when operating abroad. It is, therefore, the natural order of things in the People's Republic of China, which reveres the notion of commercial interests serving the military and the state.

The evidence is abundant. Look at the scale of Sinopec's exposure in Iran and the fact that two of its wholly-owned subsidiaries were sanctioned, on some four occasions, by



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the United States over the proliferation of chemical weapons equipment and technology to Iran. Look at CNOOC's business activities in Iran and Sudan, not to mention the provocative statements of the firm's Chairman. Look at Huawei, which has such a well-publicized kit bag of security-related concerns that it requires no further comment here.

These entities have little similarity to the thinking and intentions of normal Canadian energy majors. Accordingly, it would be well-advised for Canada to strengthen considerably its security-minded diligence in this high-stakes arena, informed, in part, by this highly questionable transaction.