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Mining Giant Scraps China Deal

By DAVID BARBOZA and MICHAEL WINES

SHANGHAI — The Chinese government's largest investment ever in a Western company, a proposed $19.5 billion stake in the Australian-British mining giant Rio Tinto Group, collapsed early Friday, dealing a blow both to China's global corporate ambitions and to its efforts to gain clout in the natural resources market.

The board of Rio Tinto announced the decision after meeting in London on Thursday, saying the company had ended the deal it struck in February to sell the stake to China's state-owned Aluminum Corporation of China, also known as Chinalco.

The board said in a statement early Friday that it had ended the deal with Chinalco and would raise about $20 billion by issuing new stock and forming a joint venture with its longtime rival, the Australian mining giant BHP Billiton, the world's largest mining company.

The China deal, which would have effectively expanded Chinalco's existing 9.3 percent stake in Rio to 18.5 percent, had drawn stiff political opposition in Australia, where mineral riches have fueled the country's prosperity and where some have begun to fear China's power in the region. Institutional investors have also expressed skepticism about the agreement, with some calling it a sweetheart deal for the Beijing government.

In a statement posted on its web site Friday, Chinalco's chairman, Xiong Weiping, said: "We're very disappointed the agreement failed."

Rio Tinto said in a statement that it had agreed to raise $5.8 billion by forming a joint venture with BHP Billiton and that it planned to raise $15.2 billion more through a stock offering.

In Australia and elsewhere, the Rio-Chinalco deal has been viewed as a corporate landmark, a crucial test of whether the West's shareholder-driven capitalism could mesh with a Chinese model that is ultimately under state control.

By collapsing, the deal will rank alongside the failed attempt by a Chinese company to take over Unocal, the American oil company, in 2005 and will provide new evidence that China's attempts to extend its global corporate reach are often limited by nationalistic backlashes abroad.

The Unocal deal collapsed amid furious debate in the United States about the wisdom of selling strategic assets to China and over China's human rights record.

Until recently, officers of both Rio and Chinalco had strongly defended the investment, which would have made the Chinese government Rio's single biggest shareholder by far and given it an advisory role in the company's operations. Chinalco would also have gained substantial stakes in individual mines in several countries.

In return, Rio would have received a sorely needed injection of cash to retire a portion of its $39 billion in debt, amassed mostly in an ill-timed 2007 purchase of the Canadian aluminum maker Alcan. Rio would have formed a strategic partnership with Chinalco that company officials say would have given it greater access to Chinese customers and opportunities to search for ores in Chinese territory.

The deal was struck at the depths of the collapse in the global commodities and stock markets last year. The share price for Rio, the world's third largest mining conglomerate, had been severely depressed not only by falling commodity prices, but also by a costly defense against a proposed and potentially lucrative takeover by its major rival, BHP Billiton.

But the tentative agreement had come under increasing fire as the global economy bounced back, pushing metals prices and Rio's own stock price up considerably from their earlier lows. Last February, shares in Rio Tinto were selling for $26.31 in London. On Thursday, they were trading at $44.56.

Institutional shareholders have complained bitterly that Rio should raise money through a new stock issue instead of selling a dominant stake to the Chinese government, which they argue has a vested interest in keeping the price of ores as low as possible.

Chinalco had insisted that it was independent of its owners in the Chinese government, and Australian regulators ruled that the Chinese would not be able to affect the price of iron ore, one of Rio's main products, even with the proposed stake in the company.

But those declarations failed to sway some critics, who argued that Chinalco's proposed investment followed the government's declared strategy of diversifying its global investments in resources as a way of hedging against price increases. The Chinese are such voracious consumers of some metals, like iron ore, that they already have some sway over its price.

Australia's political opposition savaged the proposed deal, calling it evidence that Prime Minister Kevin Rudd, a Mandarin-speaking former envoy to Beijing, was too cozy with the Chinese government. A nationally broadcast television commercial this week showed scenes of the Chinese army's 1989 assault on pro-democracy demonstrators in Tiananmen Square and charged that Mr. Rudd "bears gifts to the Chinese military regime by allowing control of strategic mineral resources in Australia."

In its statement early friday, Rio said that market conditions had recently changed and that it had found alternatives to raising a large amount of capital. "The boards have concluded that the formation of an iron-ore production joint venture in western Australia with BHP Billiton together with the rights issues deliver the best solution."

In ending the deal, Rio said it would continue to work with Chinalco and had agreed to pay Chinalco a $195 million break up fee.

Such moves are possible now, experts say, because the global financial markets have strengthened in recent weeks and commodity prices have rebounded.

As the debate over the Rio investment grew louder, Chinese officials complained about what they called protectionism and nationalism. The Australian Foreign Investment Review board, which scrutinizes deals that involve big stakes in Australian companies, was expected to rule on the China investment this month or early next month.

The proposed investment was seen as another sign of China's growing global clout and its voracious appetite for the ingredients that help produce the steel needed for the country's fast-paced building boom. Chinese companies have been on the prowl around the world over the past few years, striking supply contracts and buying corporate stakes that secure long-term access to oil, iron ore, rare earth metals and other natural resources.

The Chinese have also made major investments in recent years in real estate, agriculture and international finance. Just this week, China's sovereign wealth fund agreed to spend more than $1 billion to increase its already significant stake in Morgan Stanley, the Wall Street investment bank.

Under the Rio deal, Chinalco had offered $7.2 billion to purchase convertible bonds in Rio Tinto and $12.3 billion in cash for stakes in Rio's aluminum, iron ore and copper assets in the United States, Australia and Chile.

The bonds would eventually have converted to stock.

David Barboza reported from Shanghai, and Michael Wines from Beijing.