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THE FUTURE OF ENERGY UNDER THE USMCA

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Presenters



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ENERGY UNDER NAFTA

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Energy Under NAFTA

- The key aspects of energy under NAFTA were located under the Energy and Basic Petrochemical Chapter 6 of NAFTA
- The inclusion of this Chapter in the negotiations was perhaps the most difficult area at that time
- A relevant step to establish the basis for a future North American energy market
- Changes under USMCA and now less controversial than under original
- Rules of origin and energy proportionality

Energy Under NAFTA

- The original NAFTA Energy Chapter 6 was based on three important principles:
 1. A full respect for the constitutional restrictions of each party;
 2. The need to strengthen and increase trade of energy products and services by a gradual and sustained liberalization; and
 3. The need to create competitive energy sectors.

Energy Under NAFTA

- Under Chapter 6 of NAFTA, the parties agreed to specific provisions with respect to:
 - Import and export restrictions;
 - Export taxes and other export related measures;
 - Regulatory energy measures; and
 - National security measures
- Other specific areas of NAFTA relevant for the oil and gas sector were investor-state disputes and protection of investments

MEXICAN ENERGY REFORM

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2013 Mexican Energy Reform

- Long awaited general amendment to the Mexican Energy Provisions at all levels
- Most relevant amendments were specifically focused on Articles 25, 27, and 28 of the Mexican Federal Constitution
- Amendments published in the Federal Official Gazette on December 20, 2013
- Diverse amendments to Federal Provisions followed publication in diverse dates
- Transformation of state-owned enterprises to “for-profit State companies” (FPSC) providing a better platform for efficient competition and investment of the private sector in the energy industry
- Creation of new regulatory bodies in charge of implementation and regulation of energy related provisions as well as to establish, conduct, coordinate, and execute energy policy

General Considerations Regarding Energy Reform

- Hydrocarbons continue to be considered of Mexican ownership
- USMCA Chapter 8 replicates in an express manner the hydrocarbon ownership declaration stated since the 2013 Reform
- Specific requirements from the new administration to include Chapter 8 wording in USMCA irrespective of its general declaration nature of a provisions already included in the Mexican Federal Constitution

General Considerations Regarding Energy Reform (cont'd)

- Among the main effects arising from the Energy Reform of 2013 are:
 - Possibility for private entities to participate in hydrocarbons, electricity and gas sectors;
 - Midstream and downstream activities subject to federal permits;
 - Upstream activities carried through bidding processes, direct granting or adjudication and other kinds of specific contracts and agreements; and
 - Generation and marketing of electric power under governmental authorization and participation in transmission, distribution and other activities through agreements with the National Center for Energy Control (CENACE).

ENERGY UNDER USMCA



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Energy Under the USMCA

THE TRADE OF ENERGY PRODUCTS AMONG THE UNITED STATES, MEXICO, AND CANADA IS "ALIVE AND KICKING."

"North American trade in energy products is significant and growing. The USMCA provides a predictable framework for the United States, Mexico, and Canada to continue expanding this trade, which has been marked by rapidly increasing US exports."

Office of the US Trade Representative

Energy Under the USMCA (cont'd)

- **USMCA does not have an energy chapter and moves some of NAFTA's energy provisions to other parts of the agreement**
 - Energy chapter that had been negotiated was dropped at the request of Mexico's incoming government
 - Canada and the United States negotiated a side letter to CUSMA on energy
 - Side letter offers a fail-safe, binding guarantee that stakeholders will not be subject to treatment that is worse than what is now applied
 - Applies only to energy regulatory measures at the central level of government

Energy Under the USMCA (cont'd)

- Encourages cooperation in the energy sector
- Provisions that require Canada and the United States to establish or maintain an independent regulatory authority, and the establishment of transparency requirements for the authorization process in the energy sector
- Requirements for Canada and the United States to provide a right of appeal or judicial review of certain decisions concerning these authorizations in accordance with each Party's law
- Measures governing access to or use of energy infrastructure must be "neither unduly discriminatory nor unduly preferential"

Energy Under the USMCA (cont'd)

- **Locks-in Mexico's Energy Reform**

- The USMCA adds a new chapter specifically recognizing Mexico's ownership of hydrocarbons and its rights to reform the constitution and domestic legislation
- Other provisions in the USMCA, such as the investor-state dispute settlement (ISDS) provisions in regard to Mexico's energy sector, would help protect private US energy projects in Mexico

- **Zero Tariff in Trade of Energy Products**

Energy Under the USMCA (cont'd)

- **Addresses originating issues and pipeline transportation of hydrocarbons**
 - The USMCA allows up to 40 per cent of non-originating diluent in pipelines for transportation of crude oil without affecting the eligibility for duty free treatment under the Agreement
 - Longstanding Canadian industry request
 - The blend bitumen and heavy crude oil with condensates or diluents to transport the oil by pipeline
 - The blended crude may no longer qualify as “wholly obtained or produced” in Canada if the diluent itself did not qualify as NAFTA originating
 - Some Canadian crude shipments did not qualify for duty free treatment under the NAFTA and were subject to American duty

Energy Under the USMCA (cont'd)

- **Removal of the Proportionality Requirement**
(Article 605 in NAFTA)
 - No government measure may reduce the proportion of the supply of an energy product to the other Party based on recent export levels
 - A so-called “proportionality” provision contained in the energy chapters of both CUSFTA and NAFTA, which required Canada to export a fixed share of its energy production to the United States even in times of energy shortages

EXCEPTIONS TO ENERGY UNDER USMCA



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Reservations and Exceptions

- These are established in each chapter or in Annexes I to IV (non-conforming measures)
- Annex 2-A, exceptions to “National Treatment” and “Import and Export Restrictions”
 - Mexico established an exception for export permits pursuant to the Hydrocarbons Law
- Present and future measures exempted from USMCA principles and obligations (Annex I and II)

Non-Conforming Measures

- Each party determines:
 - Sector and subsector
 - Level of government maintaining the measure
- Exceptions set by each Party, applicable to:
 - National Treatment (NT) (investment and services)
 - Most-Favored-Nation Treatment (MFN) (investment and services)
 - Performance Requirements (investment)
 - Senior Management and Boards of Directors
 - Market Access (services)
 - Local Presence (services)

Non-Conforming Measures (cont'd)

- Non-conforming activities of a state-owned enterprise or designated monopoly (Annex IV)
- Inapplicability of:
 - Non-Discriminatory Treatment and Commercial Considerations
 - Non-Commercial Assistance

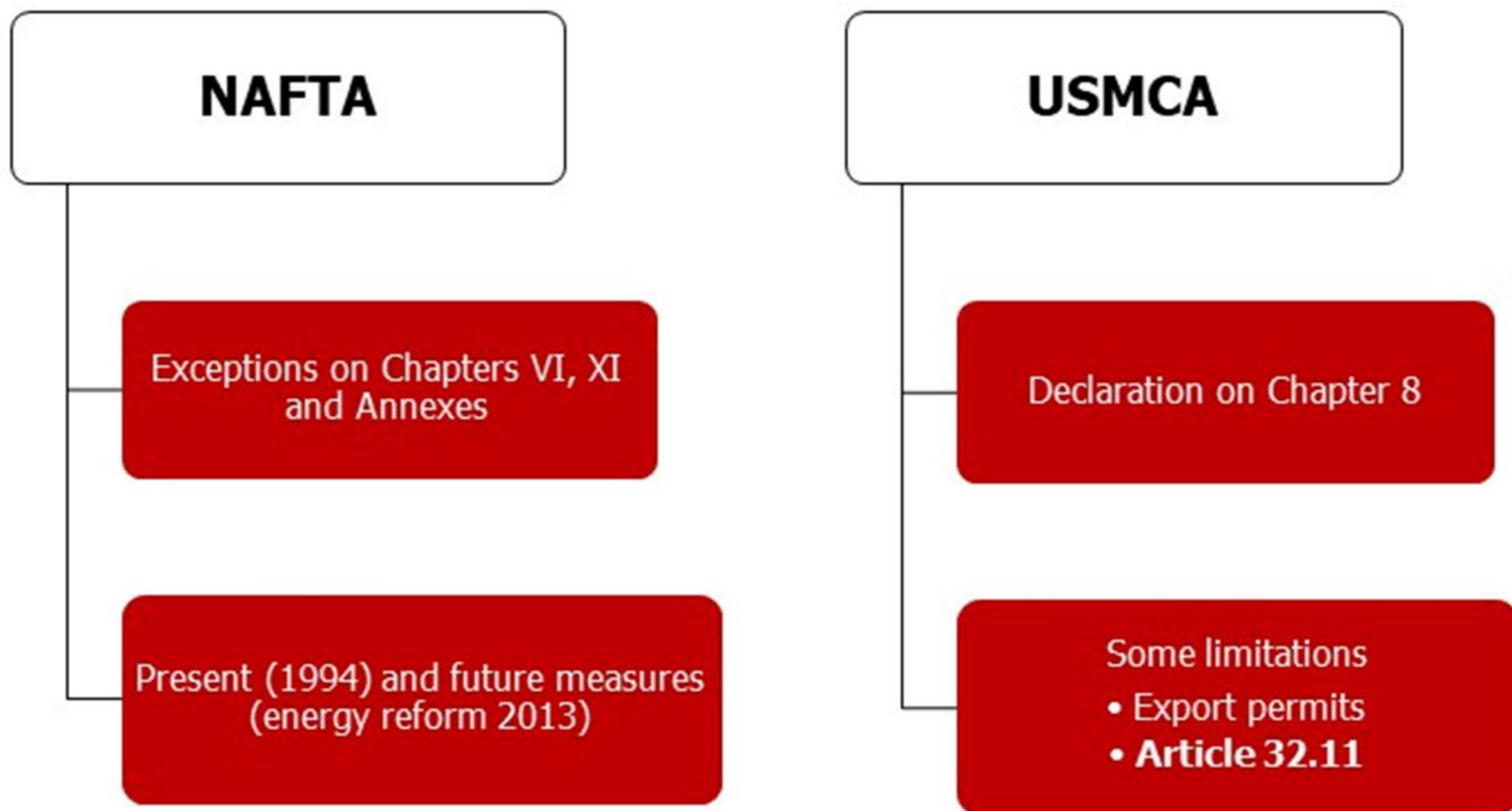
Reservations per Country (related to energy)

- Mexico:
 - Foreign investment in nuclear energy
- Canada:
 - NT, local presence and performance requirements for oil and gas
 - NT and MFN for uranium ownership
- US:
 - Investment in atomic energy
 - NT and MFN for mining (related to pipelines)

**POSSIBLE VIOLATIONS TO USMCA
DERIVED FROM THE CURRENT
MEXICAN POSITION IN CONNECTION
WITH THE ENERGY INDUSTRY**



USMCA vs NAFTA



Chapter 8

- Respect for the Parties' sovereignty and their sovereign right to regulate hydrocarbons
- In accordance with their Constitutions and domestic laws, in the full exercise of their democratic processes

NATURE? A DECLARATION OF THE PARTIES OF AN INHERENT RIGHT.

Chapter 8 (cont'd)

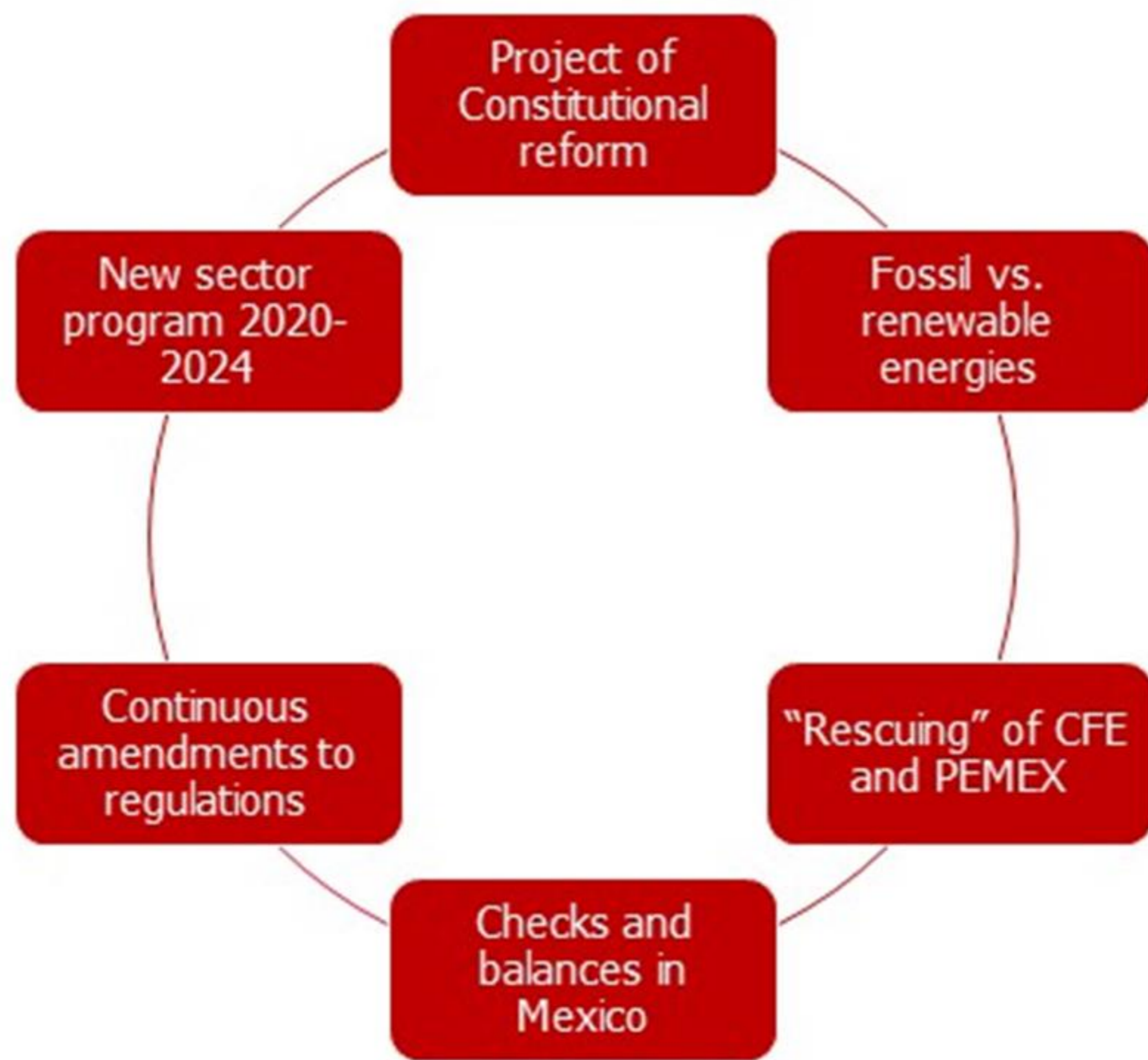
- Without prejudice to US and Canada's **rights and remedies available under USMCA**, the Parties recognize Mexico's:
 - Right to reform its Constitution and its domestic legislation
 - Direct, inalienable, and imprescriptible ownership of all hydrocarbons

EFFECT? Mexico may reform its Constitution, laws, and regulations but THESE REFORMS MUST NOT CONTRAVENE USMCA

Reservations and Exceptions

- National Treatment and access to markets (export permits)
- Present and future measures (foreign investment in nuclear energy)
- **Article 32.11 – possible additional reservations by Mexico**
 - It may adopt or maintain a measure for which it has not taken a specific reservation in Annexes I, II, and IV (related to Investment, Cross-Border Trade in Services and State-Owned Enterprises and Designated Monopolies).
 - The measure must be consistent with the least restrictive measures that Mexico may adopt or maintain under reservations and exceptions to parallel obligations in other Agreements (ratified before July 1st).

Mexico's Current Position



- Violation to domestic laws and due process of law
- Violation of international law
 - Environmental obligations
 - International trade agreements

Possible Violations and Remedies

- All measures except for export permits, foreign investment in nuclear energy and measures based on other Agreements (CPTPP)
- Investment claims (only available for US and Mexico)
 - National Treatment
 - Most Favored Nation
 - Expropriation and Compensation
- Dispute settlement mechanism due to violations of the Agreement *per se* (Chapter 31)

POSSIBILITY OF CANADA AND UNITED STATES IMPLEMENTING LEGAL REMEDIES AGAINST POTENTIAL USMCA VIOLATIONS

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USMCA Legal Remedies

(Disputes among Parties – Ch. 31)

- Closes the loopholes in the NAFTA dispute settlement mechanism that allowed NAFTA parties to block the formation of panels.
 - Adjustments enhance the enforceability of the agreement
- First consult with technical experts
 - The signatories are to make every endeavor to arrive at a mutually satisfactory resolution of all disputes arising out of the USMCA
- If they are not able to reach a resolution, Chapter 31 of the USMCA provides the framework for dispute settlement
- The Party complaining may select the forum in which to settle the dispute
 - Parties may decide at any time to undertake an alternative method of dispute resolution

USMCA Legal Remedies

(Disputes among Parties – Ch 31. - Continued)

- If that fails, a ministerial panel will review and submit an initial report (150 days + 30 days grace period if needed)
 - **15 days for comments by the Parties and 30 days for panel to issue final report**
 - If the final report finds that there is a non-compliance with a party's obligation; or a party's action is causing nullification or impairment of the scope, **the disputing parties must try to agree on the proper resolution for the dispute within 45 days**
 - If unable to resolve the dispute, **the complaining party can suspend the responding party's benefits of equivalent effect to the dispute**
 - Panel may be reconvened in certain instances by the responding party to review proposed remedial measures (90 to 120 days to resolve)

USMCA Legal Remedies

(Investment Protection Standards – Ch. 14)

- In a significant change from NAFTA, the investment chapter (Chapter 14) of the USMCA only applies to the US and Mexico
- Narrows the circumstances under which cross-border investors can bring actions under the general rules of ISDS
- Generally speaking, Chapter 14 provides access to international arbitration for general investments and **covered government contracts**
 - pre-arbitration conditions and limitations
- Investors may seek protection for breach of national treatment and most-favored-nation treatment under the general investments protections

USMCA Legal Remedies

(Investment Protection Standards – Ch 14. - Continued)

- Under the government-covered contracts protections, **investors in oil and gas and power generation may also be entitled to protection under the USMCA.**
 - While ISDS disputes are extended to **covered contracts** in the **power sector**, the definition specifically requires that **power services be provided “to the public” on behalf of a governmental authority of the host country** (read CFE in Mexico)
- The consent by Canada to ISDS for legacy investment claims will elapse three years after NAFTA's termination
- Participation of Mexico and Canada in the Trans-Pacific Partnership (otherwise known as the CPTPP)
 - Need to take a fresh look at options

QUESTIONS?

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Biography



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Ken Nunnenkamp represents clients in international trade and national security matters before United States federal courts and government agencies, including the US departments of State, Commerce, Homeland Security, Defense, and Treasury. His practice involves internal investigations and disclosures, including voluntary disclosures and responding to government demands, as well as federal court defense against government actions. He also advises on compliance counseling and training, transactional due diligence—including both domestic and cross-border transactions—and statutory submissions to US government agencies.

Biography



Humberto Padilla Gonzalez
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Humberto Padilla Gonzalez represents clients in a broad range of cross-border matters including mergers and acquisitions (M&A), investments, joint ventures, international commercial finance transactions, and contractual and simple operational matters throughout Latin America. Further, he often assists clients with respect to internal compliance investigations under the Foreign Corrupt Practices Act (FCPA), as well as data privacy issues. Humberto is also part of a cross-practice Global Workforce team providing integrated cross-border advice, counseling, and strategic planning on labor, employment, benefits, and immigration issues in Latin America. A native Spanish speaker, he is fluent in English.

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José Alberto is a partner at Sánchez Devanny who heads the International Trade and Customs practice group. He has more than 20 years of experience advising clients operating in international trade matters.

Alberto is skilled in international trade and customs matters. He has advised clients on Mexican free trade agreements, import duties, export development programs, customs and non-customs requirements, and international trade issues in mergers, acquisitions, restructurings and privatizations.

He has successfully represented national and foreign clients in customs and international trade administrative proceedings and litigation, as well as in negotiations with governmental authorities and in verification processes related to customs and foreign trade.

He was named as "The National Expert" for his participation in the article Trade & Customs 2018 included in the edition Getting the Deal Through 2017 and is ranked in Chambers and other similar publications. He is fluent in English and Spanish.

Biography



Maria Luisa Mendoza
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Maria Luisa has over 10 years of experience in unfair practices in international trade, litigation and consulting in the International Trade and Customs practices of well-known Mexican and international firms located in Mexico City. Maria Luisa has been counsel on projects with companies from several sectors, such as the automotive, textiles, steel, and pharmaceutical and food industries. Maria Luisa worked at the “Consejo Ejecutivo de Empresas Globales” on topics regarding promotion of foreign investment in Mexico, as well as a proposal of legislative reforms to enhance competitiveness, during the presidential term 2012-2018.

Maria Luisa has experience in the public sector, as she previously conducted social service at the International Trade Agreements Secretariat of the Ministry of the Economy. She was named as “The National Expert” for his participation in the article Trade & Customs 2018 included in the edition Getting the Deal Through 2017.

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Alan Ross is the Regional Managing Partner of BLG's Calgary office. Alan practises administrative and regulatory law, representing energy clients in national and provincial regulatory proceedings. He has significant experience in the areas of pipeline transmission, oil and natural gas, renewables and electricity. He also helps clients from all industries navigate the laws around international trade. He has experience resolving disputes involving NAFTA/USMCA and the Canadian International Trade Tribunal. In the energy sector, Alan has significant experience with regulators in the U.K., E.U., and the U.S. Federal Energy Regulatory Commission.

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