



How Might a U.S.-Mexico Trade Conflict Affect Trade in Natural Gas?

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U.S. Secretary of State Rex Tillerson and Homeland Security Secretary John Kelly will have their hands full Thursday when they visit Mexico. From threats of deportation and a border wall to ending Mexico's privileged trade relationship with the United States, the U.S.-Mexico diplomatic relationship under the Trump administration has become more strained than it has been in years.

While concerns about energy security may not be as immediate, they are nonetheless acute for many Mexican energy officials – as well as for many U.S. natural gas producers supplying our southern neighbor – given the size of the cross-border trade. Mexico has become increasingly reliant on cheap U.S. natural gas imports. Pipeline capacity between the two countries doubled in the past five years, and may nearly double again by the end of 2018, according to the U.S. Energy Information Administration (EIA). The share of gas in Mexico's electricity generation mix jumped from 34 to 54 percent between 2005 and 2015, and Mexican industry has staked its growth on the availability of low cost imports. The United States exported three times as much natural gas to Mexico in 2015 as it did in 2009 at the onset of the shale boom, EIA statistics indicate. In the first eleven months of 2016, the United States exported a total of 1.25 trillion cubic feet to Mexico, a remarkable 31% increase over the same period in 2015.

Indeed, substantial capital investments in U.S.-Mexico natural gas trade were made based not only on projections of a long-term supply of relatively inexpensive U.S. natural gas,¹ but also the supportive regulatory environment for energy trade between the two countries. The North American Free Trade Agreement (NAFTA) eliminated trade barriers, the Federal Energy Regulatory Commission (FERC) issued the required authorizations for the pipelines, and the Department of Energy implemented a web-based system through which applicants can expect to receive “blanket authorizations” for exports of natural gas to Mexico within weeks.

The prospect of a conflict with Mexico over trade could unsettle this regulatory environment. On the U.S. side, natural gas producers and exporters likely expect that the new Administration would not intentionally interfere with their industry. Nonetheless, some involved in the U.S.-Mexico gas trade are asking what inadvertent,

¹ See EIA, Short Term Energy Outlook: Natural Gas, at <http://www.eia.gov/outlooks/steo/report/natgas.cfm>, (showing EIA forecast prices and NYMEX futures prices for Henry Hub roughly flat through 2018).



collateral damage could be done as a result of a trade conflict driven by the politics of U.S. manufacturing and President Trump’s base in the industrial Midwest.² On the Mexican side of the border, as discussed during a recent Center on Global Energy Policy roundtable on Mexico’s energy sector in a Trump Administration, officials are increasingly worried about the damage that could be wrought should President Trump choose to use dependence on U.S. natural gas supply as leverage, as Russia has done in the past.³

The answer to both questions turns on the fate of NAFTA. NAFTA is central not only because it is the agreement through which both countries have committed to trade freely in natural gas, but also because Congress has relied on the “free trade agreement” concept in setting the level of regulatory review that exports of natural gas must undergo prior to authorization. Under current law, the Department of Energy must grant companies natural gas export authorizations “without modification or delay” to countries with which the United States has in effect a “free trade agreement requiring national treatment for trade in natural gas.” Exports to non-Free Trade Agreement countries require a public interest review, an opportunity for public comment, and an environmental review under the National Environmental Policy Act (NEPA). Exports to Free Trade Agreement countries do not.

Indeed, exports and imports of natural gas with NAFTA countries undergo regulatory processes about as complex as renewing a passport. The Department of Energy grants two-year blanket authorizations for export to Mexico within weeks. (Longer term export authorizations to Mexico and Canada require the applicant to submit a sales contract with a term greater than two years, and such requests are generally processed in months rather than weeks). Even when the issue of LNG exports became heated and politically controversial during President Obama’s first term, leading to a roughly two-year delay while the Administration studied the economic and environmental impacts, export authorizations to Mexico continued to move forward without delay.

Should Mexico no longer qualify as a free trade agreement country, a new regulatory burden would fall on U.S. exporters. Existing authorizations would likely remain in force, but within two years most U.S. exporters would need to come back to the Department of Energy for a full public interest review of the kind that LNG exporters to non-free trade agreement countries have undergone in recent years. Also of critical importance in terms of timing would be the scope of the environmental reviews that are required to accompany the public interest review. While exports over existing pipelines would be eligible for a categorical exclusion from NEPA, a recent challenge by Sierra Club working its way through the U.S. Court of Appeals for the D.C. Circuit could expand the environmental review required for exports to include the environmental impacts of natural gas production and the effect of exports on net global greenhouse gas emissions. The broader the required environmental review, the longer the approval process would take and the more litigation risk would accompany it. Ultimately,

² See e.g., *Trump-Mexico feud puts oil and gas industry on high alert*, EnergyWire, Nathan Gronewold & Jenny Mandel (Jan. 27, 2017); *Eagle Ford Shale region stewing over Trump’s Mexico rhetoric*, EnergyWire, Nathan Gronewold (Feb. 7, 2017); *Energy Cos. Unnerved By Trump’s Mexico Border Tax Talk*, Law360, Keith Goldberg (Feb. 9 2017).

³ Jason Bordoff and Tim Boersma, “For Mexico, US could become the New Russia,” CNBC (Feb. 6, 2017) at <http://www.cnbc.com/2017/02/06/for-mexico-us-could-become-the-new-russia-commentary.html>.



even assuming an Administration that views the U.S.-Mexico gas trade favorably, the delay and uncertainty associated with such reviews would pose an unwelcome interference with current commercial practice.

If natural gas prices were to spike for any reason, politicians would howl about the harm to manufacturing businesses and consumers. In such a scenario, trade could be threatened were the more cumbersome non-FTA approval process to get bogged down again in heated political rhetoric. Again, we saw this first-hand serving in the Obama Administration.

It would not take NAFTA being abandoned entirely for Mexico to no longer qualify as a free trade agreement country under the Natural Gas Act. If NAFTA is re-negotiated, new restraints on natural gas trade (such as the imposition of tariffs on U.S.-bound Mexican-origin gas) could mean that the agreement no longer qualifies as providing for “national treatment for trade in natural gas.” And, even if the natural gas provisions of NAFTA remain intact, a re-negotiated agreement that includes new tariffs or trade restrictions could invite litigation on whether NAFTA – its name notwithstanding – is still a “free trade agreement” at all. The question would be a novel one. The term “free trade agreement” is not defined in the Natural Gas Act, nor is there an authoritative definition originating in trade law. In an early LNG export case, the Department of Energy rejected an argument that the World Trade Organization agreement is a free trade agreement under the Natural Gas Act, suggesting that a free trade agreement must be something that provides for more liberalized trade rules than the WTO – a standard that a re-negotiated NAFTA might fail to meet.

And what if, as some in Mexico fear, the Administration sought to use natural gas as a weapon against Mexico or to extract leverage in a broader negotiation? Of course, the U.S. case is fundamentally different from the Russian case because U.S. natural gas exporters and pipeline operators, unlike Gazprom, are entirely private companies that would likely resist any governmental effort to interfere with the free flow of gas. And so the legal question would be whether, absent new legislation, the Executive has authority to stop the flow of gas to Mexico over the objection of the U.S. exporters and pipeline operators. If Mexico no longer qualifies as a free trade agreement country, the Department of Energy could deny export authorizations to Mexico on the grounds that they are not in the public interest. The Department’s decision would be subject to public notice and comment and a right of judicial review. But, if the Department provided a reasoned basis for its decisions rooted in U.S. foreign policy objectives, courts would likely defer.

On the other hand, if Mexico remains a free trade agreement country, a hypothetical Administration seeking to use gas exports as a weapon would have fewer options. One possibility would be to withdraw the Presidential Permits FERC has granted for cross-border pipelines. The authority to issue Presidential Permits does not come from an act of Congress but from the President’s authority to conduct foreign affairs under Article II of the Constitution. The extent of the President’s authority under Article II to control cross-border infrastructure has never been litigated and would be fraught with legal uncertainty, calling to mind what Supreme Court Justice Robert Jackson once called the “zone of twilight” in which the President and Congress “may have concurrent authority, or in which its distribution is uncertain.”

At this point, it remains unlikely that the new Administration would want to interfere with the free flow of natural gas across our border. Mexico has simply become too important of a market for U.S. producers. Nevertheless, given the importance of NAFTA to existing gas trade and the deteriorating U.S.-Mexico



relationship, preserving free trade in natural gas while re-opening other aspects of the U.S.-Mexico economic relationship will be a challenge for U.S. officials that may prove more difficult than it first appears.