

On July 20, 2022, the United States requested consultations with Mexico under the Dispute Settlement chapter of the United States-Mexico-Canada Agreement (USMCA), arguing that several of Mexico's energy policies are inconsistent with the USMCA.¹ The measures challenged by the United States affect a wide range of energy resources and technologies, including natural gas, electricity, renewable sources such as wind and solar, and diesel fuel. The United States claims that the measures at issue favor Mexican state-owned enterprises over US companies and US-produced energy, thereby violating Mexico's commitments under the USMCA chapters on Market Access, Investment, and State-Owned Enterprises, while also undermining climate objectives. The Government of Canada has stated that it agrees with the US position and has filed a parallel request for consultations, the text of which is not yet public.

If the parties are unable to resolve the dispute through consultations within 75 days, the complaining parties (the United States and Canada) may request the establishment of a dispute settlement panel to examine the measures at issue and potentially authorize retaliatory actions. This alert provides an overview of the US request for consultations and the next steps in the dispute settlement process.

US Request for Consultations

The US request covers four aspects of Mexican energy policy that allegedly "favor [Mexico's] state-owned electrical utility, Comisión Federal de Electricidad (CFE), and petroleum company, Petróleos Mexicanos (Pemex), and negatively impact U.S. companies operating in Mexico and U.S.-produced energy":

1. The Electric Power Industry Law, as amended (alleged violation of USMCA Market Access and Investment chapters)

The US request challenges a March 2021 amendment to Mexico's Electric Power Industry Law that allegedly "require[s] its grid operator Centro Nacional de Control de Energía (CENACE) to prioritize in various ways electricity produced by CFE over private competitors in dispatching electricity into Mexico's grid." Among other examples, the request cites Article 26 of the amended law, which "requires that CENACE prioritize dispatch of power generated by plants 'owned by State agencies, entities, or enterprises,'" and Article 4(V), which "'guarantee[s], in the first instance' electricity contracts of a type that only CFE can hold or enter into[.]"

The United States alleges that this measure appears to be inconsistent with provisions of the USMCA's Market Access and Investment Chapters. Specifically, the request alleges violations of Article 2.3 of the USMCA (because Mexico "has failed to accord national treatment to U.S. goods"), as well as Article 14.4 of the USMCA (because Mexico "has

failed to accord to U.S. investors and their investments treatment that is no less favorable than that it accords, in like circumstances, to Mexican investors and their investments."

2. "Inaction, Delays, Denials, and Revocations of Private Companies' Abilities to Operate in Mexico's Energy Sector" (alleged violation of USMCA Chapters on Market Access, Investment, State-Owned Enterprises, and Publication and Administration)

The US request alleges that Mexico "hinders the ability of private companies to operate in Mexico's energy sector," including by "delaying, denying or failing to act on applications for new permits or permit modifications; suspending or revoking existing permits; or otherwise blocking private companies' ability" to:

- Operate renewable energy facilities, such as wind and solar installations;
- Import and export electricity and fuel;
- Store or transload fuel; and
- Build or operate retail fuel stations.

The United States claims that these measures appear to be inconsistent with the following provisions of the USMCA chapters on Market Access, Investment, State-Owned Enterprises, and Publication and Administration:

- Article 2.3, because the measures provide treatment less favorable than that accorded to like products of national origin;
- Article 2.11, because, and to the extent, they prohibit or restrict imports or exports of a good;
- Article 14.4, because they favor Mexican investors and their investments over US investors and their investments;
- Article 22.5.2, because the relevant administrative body "is not exercising its regulatory discretion in an impartial manner with respect to enterprises that it regulates, including enterprises that are not state-owned enterprises"; and
- Article 29.3, because Mexico "is not administering its laws in a consistent, impartial, and reasonable manner."

3. Postponement of Requirement to Supply Ultra-Low Sulfur Diesel for Pemex Only (alleged violation of USMCA Market Access and State-Owned Enterprise Chapters)

The US request challenges a regulation issued by Mexico's Energy Regulatory Commission (Comisión Reguladora de Energía, or CRE) in 2019 that "grant[ed] only Pemex a five-year extension to comply with maximum sulfur content requirements under its applicable automotive diesel fuel standard[.]" The United States alleges that the measure appears inconsistent with provisions of the USMCA's Market Access and State-Owned Enterprises chapters, namely Article 2.3 (because Mexico "has failed to accord national treatment to U.S. goods") and Article 22.5.2 (because CRE "has not exercised its regulatory discretion in an impartial manner with respect to enterprises that it regulates, including enterprises that are not state-owned enterprises[.]")

4. Actions Regarding the Use of Mexico's Natural Gas Transportation Service (alleged violation of USMCA Market Access chapter)

The US request challenges an "official letter" sent by Mexico's Secretary of Energy to CRE and Mexico's National Natural Gas Control Center (Centro Nacional de Control del Gas Natural, or CENAGAS) in June 2022. According to the US request, the letter announced an energy policy and "supply guarantee strategy" that "would incentivize or require current or future users of Mexico's natural gas transportation service to source natural gas from CFE or Pemex and would impose restrictions on the importation of U.S. natural gas." For example, the US cites statements in the letter that "require" CENAGAS to "demand" that users or those interested in using Mexico's natural gas transportation service prove "that they receive the supply of Natural Gas from any of the productive companies of the State or its subsidiaries or affiliates[.]" The letter also "requires" CENAGAS to "demand" that "[a]t those points where CFE, its productive companies, or subsidiaries have reserved capacity in the upstream transportation systems, contracting with them shall be given precedence," according to the US request.

The United States claims that this measure appears to violate provisions of the USMCA's Market Access chapter, namely Article 2.3 (because it provides treatment to imported products that is less favorable than that accorded to like products of national origin), and Article 2.11 (because it is a prohibition or restriction on the importation of a good of the United States destined for Mexico.)

Next steps

The US and Canadian requests begin what could be a lengthy process of consultations and dispute settlement proceedings under Chapter 31 of the USMCA. This process could result in the United States and Canada imposing retaliatory measures, in the event that (1) the dispute proceeds to the panel stage; (2) the panel finds that Mexico's measures are inconsistent with the USMCA; (3) and the parties are unable to agree on a resolution. The next steps in the dispute settlement process are as follows:

- In accordance with Article 31.6 of the USMCA, the parties will have 75 days to resolve the matter through bilateral consultations (i.e., until October 3, 2022), unless they agree on a different time period. If they fail to resolve the matter during the applicable timeframe, the complaining Parties (the United States and Canada) will be permitted to request the establishment of a dispute settlement panel to determine whether the measures covered by the request are inconsistent with the terms of the Agreement. The process of arriving at a panel ruling would involve several procedural steps, including a panel composition process,² and the issuance of a panel report within prescribed time frames.³ In total, the issuance of a final panel report would likely occur no earlier than 315 days after the date on which the request for consultations was submitted.
- USMCA panel reports must contain (1) "findings of fact"; (2) determinations as to whether the measure at issue is inconsistent with obligations in the Agreement, or a Party has otherwise failed to carry out its obligations in the Agreement; and (3) recommendations, if the disputing Parties have jointly requested them, for the resolution of the dispute.⁴ If the panel finds that Mexico's measures are inconsistent with the USMCA, the parties "shall endeavor to agree on the resolution of the dispute."⁵ If the disputing Parties are unable to agree on a resolution within the 45-day period, the complaining parties would be permitted to suspend the application to the Mexico of benefits "of equivalent effect to the non-conformity" until the disputing Parties agree on a resolution.⁶ Typically, this involves the imposition of retaliatory tariffs on goods of the responding party.

In the United States, there is strong political support for the Biden Administration's decision to pursue the dispute, both from the business community and Members of Congress. These stakeholders have argued that the Mexican policies at issue not only disadvantage US companies, but also raise concerns about whether Mexico can meet its climate goals under the Paris Agreement.⁷ The latter issue is of particular concern to the Biden Administration and Democratic Members of Congress.

Whether this dispute is resolved through consultations or a formal panel proceeding, it may have important implications for the North American energy sector, particularly given that the challenged measures affect a wide range of energy resources and technologies from renewables to fossil fuels. Importantly, the USMCA's Rules of Procedure allow a Panel to consider written views submitted by non-governmental entities during the course of the dispute, in addition to hearing the views of the disputing Party governments.⁸ Companies should examine the implications of this USMCA dispute and consider strategies to protect their commercial interests.