Portfolio Media. Inc. | 111 West 19th Street, 5th Floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Energy Cos. Unnerved By Trump's Mexico Border Tax Talk

By **Keith Goldberg**

Law360, New York (February 9, 2017, 6:22 PM EST) -- President Donald Trump's recent vow to impose import taxes on Mexican goods to pay for a border wall is stoking concerns among energy firms that have cashed in on increasing Mexican demand for U.S. natural gas and petroleum products, and could chill new investment in cross-border infrastructure if Trump follows through on his threat, experts say.

The Trump administration has floated a 20 percent border tax to pay for a wall on the U.S.-Mexico border, potentially as a condition to renegotiating the North American Free Trade Agreement between the U.S., Mexico and Canada. That has the potential to upset cross-border trade flows across a number of industries, but energy is a particularly noteworthy example, experts say.

Mexico is the U.S.'s largest energy trading partner behind Canada, with U.S. gas and refined fuels flowing south and Mexican crude oil flowing north, according to a report released Thursday by the U.S. Energy Information Administration.

The trading balance has tipped in favor of the U.S. in recent years, with $20.2 billion worth of U.S. energy exports sent to Mexico compared to $8.7 billion worth of U.S. energy imports from Mexico, according to the EIA report. Much of that is fueled by growing demand for cheap and plentiful U.S. gas to power Mexico's electricity sector; U.S. gas exports to Mexico have jumped from 2.9 billion cubic feet per day in 2015 to a projected 4.2 billion cubic feet per day, according to the EIA report.

“There is a great co-dependency between the countries in this area,” said Benjamin Torres-Barron, who leads Baker & McKenzie LLP's energy, mining and infrastructure practice group in Mexico.

A steep tariff on Mexican imports could hamper the country's economic growth, decreasing its energy demands, experts say. The impact would be compounded if Mexico retaliates with tariffs of its own that make U.S. energy exports more expensive. That would eventually hit U.S. producers in the wallet, forcing them to find other markets and ways to sell their gas and potentially scale back production, experts say.

“It sets off a series of dominoes,” said Carlos Sole, who co-chairs Baker Botts LLP's Latin America practice.

One such domino could be an eventual slowdown in what to this point has been rapid construction of new cross-border infrastructure connecting U.S. producers to Mexico — mainly, gas pipelines and storage facilities. The EIA said in December that U.S. pipeline capacity for gas exports into Mexico will nearly double over the next three years, with six pipeline projects originating in shale-rich Texas expected to be shipping gas into Mexico by the end of 2018. That dovetails with a significant expansion of Mexico's existing pipeline network, including 12 new pipelines currently being developed, the EIA said.

“The return on investment for pipelines might diminish based on less demand,” Torres-Barron said.

The talk of an import tax comes amid Mexico's ongoing denationalization of its energy sector in order to boost its energy production. The landmark reforms enacted in 2013 are well underway, with the Mexican government holding auctions for onshore and offshore oil and gas exploration, as well as opening up electricity projects to private and foreign investment.

But while the U.S. is a natural market for Mexican oil, and U.S.-based energy companies have been significant participants in exploration and production auctions and infrastructure project solicitations, a trade war between the two nations likely won't slow down Mexico's denationalization train, experts say.

“The opening of Mexico is an opening to the entire world and an opening to its own private sector,” said Jose Valera, who co-heads Mayer Brown LLP's oil and gas practice. “There is a tremendous appetite on behalf of Mexican companies themselves to invest in the energy industry.”

And experts caution that for all the tough talk coming from the Trump administration, and equally tough responses from the Mexican government, the impact of border taxes and NAFTA renegotiations on energy and energy infrastructure development still requires a crystal ball that no one has.

“Given where we are today, we're a long way from drawing a direct line between proposals and statements and the type of economic downturn in Mexico that would adversely affect the development of this infrastructure,” Valera said.

For U.S. energy companies, their level of concern depends on how heavily invested they are in Mexico, according to Sole. Companies that are already well-entrenched will likely be content to ride things out, and companies that have just started to invest will likely take a similar long-term view, he said.

But for companies that haven't yet dived into Mexico's energy sector, a breakdown in U.S.-Mexico trade relations could give them pause, Sole said.

“Your risk profile has changed, you have a greater degree of uncertainty in terms of what the U.S.-Mexico relationship will be,” Sole said. “I think it could certainly have a chilling effect, yes, particularly on the oil and gas side.”

Companies must decide whether to head into Mexico regardless of the uncertainty or stay in the U.S., where the Trump administration has pledged to ease regulatory burdens to open up domestic oil and gas production.

“The overhang of this is while oil prices have recovered, they're still in the mid-50s, so it's still a challenging environment,” Sole said.

The border tax, along with a renegotiation of NAFTA, is part of Trump's pledge to boost U.S. exports. The irony of border tax potentially harming energy exports likely isn't lost on key members of his administration, experts say. After all, Trump's Secretary of State Rex Tillerson is the former CEO of ExxonMobil Corp., and his energy secretary nominee, Rick Perry, is the former governor of Texas, which benefited as much as any state from increasing Mexican demand for U.S. gas.

“There will be a strong debate within the Cabinet as to what policies to make,” Sole said.

--Additional reporting by Alex Lawson. Editing by Christine Chun and Philip Shea.