State Bar of Texas International Law Section

INTERNATIONAL NEWSLETTER

Winter 2020, Volume 2, No. 1

ilstexas.org

In this first issue of 2020, the International Newsletter looks forward to the International Law Section's event in Toronto, Canada in May 2020.

INTERNATIONAL LAW SECTION
THE STATE BAR OF TEXAS

IN THIS ISSUE

DEPARTMENTS

ARTICLES

GABRIELA N. SMITH

ILS Chair of the State Bar of Texas

Message from Gabriela N. Smith

Happy 2020! At the Texas ILS, we have much to celebrate from 2019, and have much to look forward to in 2020.

Last year, we had an exciting year focusing our efforts on the U.S.-Mexico relationship. The ILS held its Annual Trip in Mexico City and dedicated a large portion of its CLE hours and events throughout the year to the topic of legal issues when doing business in Mexico. This included participation of renowned Mexican attorneys in our Annual Institute – our staple event. The ILS also generated numerous long-lasting relationships with Mexican legal counsel, thus creating a channel of communication and cooperation between lawyers in Texas and Mexico.

This year, we are turning our attention north and we'll be hosting our Annual Trip in Toronto, Canada on May 6-8. During this trip, participants will be able to learn more about U.S.-Canada relations as well as foster relationships with Canadian legal counsel. Texas international lawyers are in for a treat, and Toronto, as always, will offer great sights, as well as cultural and culinary experiences. (Did anyone say Poutine?)

This year will also feature a great deal of focus on two specific topics that are of great importance in our time: human rights and technology/innovation.

Through the impact of the ILS' International Human Rights Committee (IHRC), Texas has continued to have an ongoing presence and leadership in the topic. Most notably, the IHRC recently worked with mayors' offices in Houston, Dallas, and Austin to declare December 10 the International Human Rights Day. And, of course, technology cannot escape the international business landscape. From oil and gas exploration and energy, to aircraft mechanics, to human resources – and everything in between – the use of applications, software, and innovation are ever present shaping and re-shaping the legal landscape and operations of companies. We will devote CLE time to the importance and impact of technology in the international context in topics such as privacy, artificial intelligence, intellectual property, and more, and will cover a variety of industries within those topics.

This issue of the International Newsletter covers the topics that continue to concern international legal counsel: U.S.-Canada relations, updates on regulations in Mexico, international trade, CFIUS, and USMCA. We appreciate each author and law firm that contributed an article.

We look forward to an exciting 2020. As you peruse this edition of the ILS' International Newsletter, check out the events coming up in 2020, including the Annual Institute in Dallas on April 23-24, the Toronto Trip on May 6-8, and the Annual Meeting in Dallas on June 25. I look forward to seeing you there. More information and registration to our events is available at ilstexas.org. ■

STATE BAR OF TEXAS INTERNATIONAL LAW SECTION

ANNUAL INSTITUTE

APRIL 23-24, 2020 | SMU CAMPUS - DALLAS, TX

2019-2020 SPONSORSHIP OPPORTUNITIES

INTRODUCTION

The International Law Section of the Texas State Bar keeps Texas lawyers on the cutting edge of international legal issues affecting their practice. Your generous support allows us to provide law students and practicing attorneys with several CLE presentations in major cities across the state, a two-day Annual Institute with top legal experts, a quarterly International Newsletter, and opportunities to network, lead committees and travel to a foreign country for education and cultural exchange.

GOLD SPONSOR- $5,000

BENEFITS

- NAME & LOGO ON OUR WEBSITE
- NAME & LOGO IN OUR PROGRAM
- PUBLIC RECOGNITION
- NAME & LOGO IN OUR MONTHLY E-NEWSLETTER
- ONE EXHIBIT TABLE
- 10 COMPLIMENTARY REGISTRATIONS

SILVER SPONSOR- $3,500

BENEFITS

- NAME & LOGO ON OUR WEBSITE
- NAME & LOGO IN OUR PROGRAM
- PUBLIC RECOGNITION
- NAME & LOGO IN OUR MONTHLY E-NEWSLETTER
- ONE EXHIBIT TABLE
- 5 COMPLIMENTARY REGISTRATIONS

BRONZE SPONSOR - $2,500

BENEFITS

- NAME & LOGO ON OUR WEBSITE
- NAME & LOGO IN OUR PROGRAM
- PUBLIC RECOGNITION
- NAME & LOGO IN OUR MONTHLY E-NEWSLETTER
- PROMOTIONAL MATERIAL ON OUR INFORMATION TABLE
- 2 COMPLIMENTARY REGISTRATIONS

HUMAN RIGHTS SPONSOR- $1,000

OUR INTERNATIONAL HUMAN RIGHTS COMMITTEE (IHRC) CREATED THIS SPECIAL SPONSORSHIP CATEGORY THIS YEAR TO INCREASE AWARENESS OF AND INFORMATION ON HUMAN RIGHTS ISSUES AMONG TEXAS LAWYERS AND U.S. COMPANIES.

BENEFITS

- NAME ON OUR WEBSITE
- NAME IN OUR PROGRAM
- 1 COMPLIMENTARY REGISTRATION

DEADLINES

MARCH 25, 2020 IS THE DEADLINE TO TURN IN YOUR SPONSORSHIP MONIES, LOGO AND REGISTRATIONS

CONTACT US:

GABRIELA SMITH

ILS CHAIR, 2019-2020
gsmith@gnslawpllc.com
214.901.2010

DOWNLOAD SPONSORSHIP FORM: ILSTEXAS.ORG/SPONSORS-2

TOM WILSON

Editor-in-Chief
International Newsletter

Editor-In-Chief Message

Looking North and South

This edition of the ILS International Newsletter is a reflection of 2019 and a preview of 2020 for the Texas ILS. In 2019, the ILS concentrated on Mexico, culminating in a trip to Mexico City in April 2019. The ILS now turns its eye north to Canada where it will travel in May 2020. More details on this trip are included in this newsletter.

It is altogether fitting that the ILS of Texas concentrates on Mexico and Canada as the international trade agreement between the United States and those countries, often referred to in the U.S. as the USMCA, is being finalized. In looking to Mexico, we address in this edition clean energy issues, workplace safety issues, and of course the impact of the USMCA. In the beginning of our look to the north, we concentrate on trade issues between Canada and the U.S. and go far to the north to address maritime issues in the Northwest Passage. Generally, we also address issues related to CFIUS and due diligence in international transactions.

As can be seen in these pages, the ILS International Newsletter continues to strive to provide information across practice areas for lawyers in Texas. I hope you find these articles informative and that they encourage you to submit an article for the Spring edition of the ILS International Newsletter. ■

On Thin Ice: The Interplay of Distinct International Concerns in Determining the Development of Shipping through the Northwest Passage

BY AUSTIN PIERCE
Vinson & Elkins, Houston

Introduction

The Northwest Passage has long captured commercial imagination. Since at least 1496, with King Henry VII of England's grant of letters patent to John Cabot and his sons[1] various groups and intrepid adventurers have sought to bridge the gap between the Atlantic and Pacific Oceans via the Western Arctic. That idea was quite literally put on ice for most of modern human history, but warming oceans have caused renewed interest in Arctic maritime routes at the same time environmental activists are desperately trying to preserve the region.[2] Canada has long held that the waters of the Canadian Arctic Archipelago ("CAA") are part of the country's internal waters,[3] whereas several other countries argue that the Northwest Passage is an international strait under the United Nations Convention on the Law of the Sea ("UNCLOS"). Such a designation would prohibit Canada from barring ships a right of transit through the passage.[4] The answer is by no means clear-cut. This article examines the origins of the dispute and the merits on both sides before examining how the implementation of certain environmental regimes has potentially served to check the issue without directly arguing under UNCLOS.

Development of the Dispute

While of theoretical concern earlier, the dispute kicked off in earnest after the passage of the oil tanker *S.S. Manhattan* through the CAA in 1969.[5] Despite being accompanied by a Canadian Department of Transport icebreaker,[6] the trip sparked a public outcry amongst the Canadian populace. This resulted in the Canadian government passing the Arctic Waters Pollution Prevention Act in 1970, establishing a 100-nautical-mile offshore zone for pollution control,[7] an act which the United States vociferously contested.[8]

Tensions flared up again in the mid-1980s when the United States Coast Guard icebreaker *Polar Sea* passed through the CAA without seeking permission from the Canadian government, resulting in Canada's declaration of all waters within certain baselines around the CAA to be internal waters and subject to Canada's territorial jurisdiction.[9] This move was based in significant part on the International Court of Justice ("ICJ") 1951 *Anglo-Norwegian Fisheries* case, which allowed Norway to draw straight baselines

and encase a region of water as internal due to its highly irregular land formations with deep indentations, protruding juts, and offshore fringing islands.[10] Canada has argued that it is likewise entitled to demarcate such baselines around the CAA, and several commentators regard this as a strong claim.[11] Nevertheless, nations such as the United States that would like a right of unfettered transit have argued that the Northwest Passage, including the various routes through the CAA, consists of international straits, pointing to both the ICJ 1949 *Corfu Channel* case and the transit passage regime in UNCLOS.[12] Importantly, waters that had not previously been considered internal but were made so due to use of the straight baseline method would not be considered so for purposes of determining a right of transit passage under UNCLOS.[13]

However, instead of litigating the issue, Canada and the United States brokered an agreement that essentially let the nations agree to disagree in their interpretations.[14] The Arctic Cooperation Agreement resolved the immediate concern of transit by U.S. government ships; however, little thought was given at the time to the implications of melting sea ice. In the 25-year span from 1990 to 2015, traffic through the Northwest Passage nearly tripled.[15] Most of that growth has come during the last decade, with cargo, fishing, and pleasure craft becoming increasingly common.[16] Therefore, the classification of the Northwest Passage has again become one of strategic concern.

International Straits

The right of transit passage afforded by UNCLOS applies in straits: (1) that are used for international navigation, (2) that connect one part of the high seas or an exclusive economic zone ("EEZ") to another part of the high seas or EEZ, and (3) for which there are no similar routes through the strait through the high seas or EEZ of similar navigational and hydrographical convenience.[17] The first two conditions essentially codify the criteria set forth in the *Corfu Channel* case,[18] while the third prevents abuse of the transit passage regime when other, equally viable routes exist.

However, the criteria do not firmly settle the question of the Northwest Passage. Firstly, the CAA presents a unique situation. Unlike in many traditional international straits—like the Straits of Malacca, Messina, or Hormuz—navigating the CAA, in most cases, requires traveling through several straits that do not independently connect one area of high seas or EEZ to another. Therefore, independently, the various straits would not be covered by the regime of transit passage discussed in UNCLOS. However UNCLOS, as drafted, states that the transit passage regime "applies to straits which are used" for navigation between such portions of high seas or EEZs. It does not specify that the connection must be through a single strait as defined geographically. And the straits, taken together, would be used for navigation between parts of the high seas or EEZs, aligning verbatim with the language in UNCLOS. Therefore, the various straits of the CAA most likely would not wriggle out of the regime of transit passage solely by their multiplicity.

Instead, the main point of contention in the international strait argument is the navigation requirement. While UNCLOS Article 37 states that transit passage applied to straits "which are used for international navigation," no guidance is given on what qualifies as such navigation. Here again, the Northwest Passage differs from many traditional such straits, as Arctic routes have physically been sealed off to international navigation for most of history. Canada points to this dearth of navigation to support its claim that the waters of the Northwest Passage should not be considered international straits where a right of transit passage applies. Potential use is insufficient to satisfy the requirement; there must be actual use.

Nevertheless, these waters have not been wholly void of international navigation; though sparse, transit has occurred in the region—even prior to UNCLOS, as voyages such as that of the *S.S. Manhattan* show. The question then becomes what amount of navigation is required. Several commentaries on UNCLOS point out that efforts to append qualifiers—such as 'normally,' 'customarily,' or, Canada's own submission, 'traditionally'—to such use were all rejected.[19] This may suggest that even a modicum of use for such purposes is sufficient.

The complexity of this analysis is redoubled given the peculiar nature of these waters, where such navigation has been inhibited by icy barriers. These distinct characteristics have led some commenters to suggest that certain allowances be made in analyzing the use of polar regions.[20] Such an approach has a certain logic to it. In areas of the world where the waters are not regularly frozen, "potential use" versus "actual use" provides a meaningful distinction; when ships could easily pass through a strait but routinely choose not to, the presumption is that the strait does not present the sort of utility that the transit passage regime was meant to protect. In such a circumstance, arguing that the strait has potential use (at least in the sense of utility) is contraindicated by consistent, historical lack of actual use. However, the distinction has, until recently, been rendered meaningless in the Arctic. The impossibility of traversal precluded potential or actual use. The question has only become meaningful as a warming climate causes polar straits like the Northwest Passage to open. To then point to a lack of robust actual use and to argue that potential use is insufficient is to ignore that, until a matter of years ago, there was neither potential nor actual

use. And as the Northwest Passage has opened up, the amount of actual use has increased substantially.[21] While it is still far from a crowded thoroughfare, the increase in traffic would lend credence to the argument that the only reason the Northwest Passage has not been used for significant international navigation was the physical impossibility of doing so.

The degree of use required by the transit passage regime will likely depend on how decisionmakers conceptualize UNCLOS and the degree of adaptability that parties meant to build into its terms. But such decisions are themselves informed by other questions of the day. One such question will inevitably be how to weigh the impacts of climate change that have enabled such navigation. The environmental implications have not been missed by shippers, environmental activists, or the Canadian government.

The CAA Chessboard

On July 30, 2019, Canada designated nearly 320,000 square kilometers of ocean in the north of the CAA as the Tuvaijuittuq Marine Protected Area ("Tuvaijuittuq").[22] Tuvaijuittuq plays directly into climate politics; the name itself means "the place where the ice never melts," as it is expected to be one of the last refuges of year-round sea ice.[23] It also helps Canada to meet commitments in other areas of international law. For example, as part of the Convention on Biological Diversity Aichi Targets, Canada has committed to establishing a network of protected areas that include at least 10% of the country's coastal and marine areas.[24] Tuvaijuittuq accounts for approximately 5.55% of Canada's total coastal and marine area and caused the country to both meet and exceed its commitment under the Aichi Targets.[25]

The publication of the order establishing Tuvaijuittuq states that the order acknowledges obligations under international law, such as UNCLOS;[26] nevertheless, Tuvaijuittuq establishes a moral and reputational barrier to entry, if not a direct legal one. And, importantly, Tuvaijuittuq is not the only protected portion of the CAA. Another significant region is the Tallurutiup Imanga National Marine Conservation Area ("Tallurutiup Imanga"), which covers almost 2% of Canada's coastal and marine area.[27] These areas have been documented as important for preserving Arctic ecosystems and a host of rare species, but they also cover most of the waterways connecting to the eastern end of the CAA.

> "The classification of the Northwest Passage has again become one of strategic concern."

By leveraging the environmental fragility and importance of the regio ı, Canada can putatively acknowledge obligations under UNCLOS while simultaneously mobilizing another international obligation to promote desired, but less directly achievable, goals. In essence, the CAA becomes a chess board, with legal regimes serving as the pieces with which various nations can play. By positioning certain pieces in specific ways, Canada has made any moves against its interests in the region more difficult and costly.

This is not to say that Canada has established these marine reserves with the sole purpose of creating non-legal barriers to use of the Northwest Passage; however, Canada's choice of marine reserve designations has strategically constrained the number of routes through the CAA that would not run through some area that has been established as an ecological sanctuary.[28] Notably, Tallurutiup Imanga comprises the single largest and most direct route to and from the east end of the CAA. And together with Tuvaijuittuq, it leaves ships with only one non-protected route. This route, the Fury and Hecla Strait, is much narrower than other paths through the CAA, and it has certain characteristics that make it less suitable for a variety of ships to navigate.[29] This lack of navigability would exculpate a ship from having to use the passage under UNCLOS, as a path of lesser convenience. But by positioning a marine reserve in the preferred route, Canada has forced any ship, especially ships with large and potentially deleterious loads, considering transit through the CAA to weigh convenience against the reputational concerns of traipsing through established ecological reserves with their cargo.

Attitudes in Shipping

The environmental consequences of traversing Arctic routes, including the Northwest Passage, has not gone unnoticed by shipping companies. This discussion has sliced both ways. The Arctic routes are shorter, generating significant fuel savings.[30] This, along with lower transit speeds decreasing fuel consumption, is generally associated with lower CO2 emissions compared to other routes.[31] The exact climate impact of these routes is less certain, as other more potent, shorter-lived emissions are increased;[32] however, the idea of shorter, more fuel-efficient transit is a potential appeal of these routes from both economic and environmental perspectives.[33]

On the other hand, the increasing rarity and fragility of Arctic ecosystems gives some entities pause when

considering shipping through the region. Indeed, in one study of considerations for using Arctic shipping routes, fuel costs and environmental concerns stood adjacent to each other among major considerations in such decisions.[34]

Some companies have taken the position that the reduced transit times are not worth the environmental risks. Several corporations have signed the Arctic Shipping Corporate Pledge, including consumer goods companies such as Gap Inc. and Nike as well as shipping carriers such as CMA CGM, Mediterranean Shipping Company, and Hapag-Lloyd.[35] While, at the moment, such pledges may represent little more than zero-cost "greenwashing," the decision of three of the five largest container shipping companies to avoid Arctic routes is substantial enough to suggest that highlighting environmental concerns can actually, at least for the time being, impact decisions in using these routes. The establishment of environmental sanctuaries at key shipping transit points in the region only serves to raise the consideration given to such issues.

Conclusion

The opening of the Arctic has reinvigorated interest in the region from economic, environmental, legal, and political perspectives. It has simultaneously reopened issues that have for earlier periods in history largely been considered moot, such as the status of the Northwest Passage. If Canada wishes to have other nations accept its position that the Northwest Passage consists of internal waters, then it must do so sooner rather than later. As the region continues to warm, the passage will become more valuable from an economic and efficiency standpoint. The legal status of the region under UNCLOS is subject to substantial debate. Rather than directly pursuing its goals under that regime, Canada may choose to leverage other international regimes along with environmental politics in achieving its goal. Portions of the CAA are expected to be some of the last refuges for Arctic sea ice. Several major shipping entities have already pledged to avoid Arctic routes such as the Northwest Passage due to environmental concerns. Thus, by highlighting the increasing environmental rarity and fragility of the region, Canada may be able to prevent the majority of transit through the CAA without directly arguing the merits of the perspective under UNCLOS.

●●●

Austin Pierce is an associate at Vinson & Elkins LLP, where his practice focuses on environmental law. Prior to practice, Austin graduated from Duke University School of Law with both his J.D. and an LL.M. in International & Comparative Law. ■

Endnotes

1 Henry Percival Biggar, The Precursors of Jacques Cartier, 1497–1534: A Collection of Documents Relating to the Early History of the Dominion of Canada 7–10 (1911).

2 Although the sloop Gjøa successfully navigated the passage in 1906 (*See* Amundsen, Roald, Vol. I Exploring Polar Frontiers: A Historical Encyclopedia at 13 (William James Mills, 2003)), the first unescorted voyage by a cargo ship through the Northwest Passage took place in 2014, several centuries after the first such attempts. Becky Oskin, *Cargo Ship Makes 1st-Ever Solo Trip Through Northwest Passage*, Live Science (Oct. 1, 2014), *available at* https://www.livescience.com/48105-cargo-ship-solos-northwest-passage.html. And overall shipping traffic nearly tripled in the period from 1990 to 2015. Malte Humpert, *Canadian Arctic Shipping Traffic Nearly Tripled Over 25 Years*, Arctic Today (Mar. 15, 2018), available at https://www.arctictoday.com/canadian-arctic-shipping-traffic-nearly-tripled-25-years/.

3 *See, e.g.*, Royal Canadian Navy, Canada in a New Maritime World LEADMARK 2050 1, available at http://navy-marine.forces.gc.ca/assets/NAVY_Internet/docs/en/rcn_leadmark-2050.pdf.

4 See United Nations Convention on the Law of the Sea ("UNCLOS") at Art. 38.

5 See, e.g., Donald E. Nevel & W.F. Weeks, *The Voyage of the S.S. "Manhattan"*, 62 The Military Engineer 80, 80 (1970).

6 *Id*.

7 *See* Shelagh D. Grant, *Arctic Governance and the Relevance of History*, in Governing the North American Arctic: Sovereignty, Security, and Institutions 29, 42 (Dawn Alexandrea Berry et al. eds., 2016).

8 J.A. Beesley & C.B. Bourne, *Canadian Practice in International Law during 1970 as Reflected Mainly in Public Correspondence and Statements of the Department of External Affairs*, 9 Canadian Yearbook of International Law 276, 287–88 (1971).

9 *See* Grant, *supra* note 7, at 43.

10 *See* Fisheries Case (United Kingdom v. Norway), Judgment, 1951 I.C.J. 116 (Dec. 18).

11 *See, e.g.*, Donald R. Rothwell, *The Canadian-U.S. Northwest Passage Dispute: A Reassessment*, 26 Cornell International Law Journal, 331, 359 n. 135 (1993).

12 *See* The Corfu Channel Case (United Kingdom v. Albania), Judgment, 1949 I.C.J. 4 (Apr. 9); UNCLOS, *supra* note 4, at Art. 37.

13 UNCLOS, *supra* note 4, at Art. 35(a). While Canada argues that these waters have long been internal, this view would likely face intense scrutiny even if Canada's international counterparts were to accept the claim that the waters are internal under the straight baseline approach.

14 *See* Agreement Between the Government of Canada and the Government of the United States of America on Arctic Cooperation ("Arctic Cooperation Agreement"), Canada-U.S., Jan. 11, 1988 ("Nothing in this agreement…affects the respective positions of the Governments of the United States and of Canada on the Law of the Sea in this or other maritime areas").

15 Humpert, *supra* note 2.

16 *Id.*

17 UNCLOS, *supra* note 4, at Art. 36–37.

18 *See* The Corfu Channel Case, *supra* note 12. Although this case discusses "innocent passage", innocent passage has a different context under UNCLOS, making "transit passage" the more appropriate analog.

19 *See*, e.g., Jose A. De Yturriaga, Straits Used for International Navigation: A Spanish Perspective 3–4 (1991); S.N. Nandan & D.H. Anderson, *Straits used for International Navigation: A Commentary on Part III of the United National Convention on the Law of the Sea 1982*, 60 British Yearbook of International Law 159, 169 (1989).

20 *See, e.g.*, Donat Pharand, *The Northwest Passage in International Law*, 17 Canadian Yearbook of International Law 99, 114 (1979); William E. Butler, Northeast Arctic Passage 135 (1978). It is important to note, however, that Pharand ultimately concludes that, even with such allowances, the Northwest Passage should be considered internal to Canada. *See* Pharand, *supra* note 19, at 112–13.

21 Humpert, *supra* note 2.

22 Order Designating the Tuvaijuittuq Marine Protected Area, SOR/2019-282 (Can.), available at http://www.gazette.gc.ca/rp-pr/p2/2019/2019-08-21/html/sor-dors282-eng.html.

23 Tuvaijuittuq Marine Protected Area, Fisheries and Oceans Canada (August 1, 2019), *available* at https://www.dfo-mpo.gc.ca/videos/tuvaijuittuq-eng.html.

24 Canada – National Targets, Convention on Biological Diversity, *available at* https://www.cbd.int/countries/targets/?country=ca (last accessed Nov. 18, 2019).

25 *Supra* note 22.

26 *Id.*

27 Tallurutiup Imanga National Marine Conservation Area, Parks Canada, *available at* https://www.pc.gc.ca/en/amnc-nmca/cnamnc-cnnmca/tallurutiup-imanga (last accessed Nov. 18, 2019).

28 For a map, *see* Canada's marine protected and conserved areas, Fisheries and Oceans Canada, *available at* https://dfo-mpo.gc.ca/oceans/maps-cartes/conservation-eng.html (last accessed Nov. 18, 2019).

29 As one notable example, the eastern end of the strait is dotted with several islands, and the room for passage is shrunk even further through a stretch called the Labrador Narrows. *See id.*

30 *See, e.g.*, Anita Parlow, *The Ice is Melting: Is Arctic Shipping Warming Up?*, American Journal of Transportation (Apr. 22, 2019), available at https://www.ajot.com/premium/ajot-the-ice-is-melting-is-arctic-shipping-warming-up.

31 *Arctic Sea Shipping: Emissions Matter More Than You Might Think*, Marine Insight (Nov. 4, 2019), *available at* https://www.marineinsight.com/green-shipping/arctic-sea-shipping-emissions-matter-might-think/.

32 *See id.*; J.J. Corbett et al, *Arctic Shipping Emissions Inventories and Future Scenarios*, 10 Atmospheric Chemistry and Physics 9689 (2010).

33 Po-Hsing Tseng & Kevin Cullinane, *Key Criteria Influencing the Choice of Arctic Shipping: A Fuzzy Analytic Hierarchy Process Model*, 45 Maritime Policy & Management 422, 434 (2018).

34 *Id.*

35 Morgan Forde, *As Nike Pledges No to Arctic Shipping, Gap, H&M and More Sign On*, Supply Chain Dive (Oct. 28, 2019), *available at* https://www.supplychaindive.com/news/nike-ocean-conservancy-pact-no-arctic-shipping/565920/; Greg Knowler, *MSC Says No to Arctic Shipping Route*, Journal of Commerce (Oct. 17, 2019, 10:44 AM), *available at* https://www.joc.com/maritime-news/msc-says-no-arctic-shipping-route_20191017.html; Michael Angell, *CMA CGM Will Not Ship via Arctic Waters as Part of Green Pledge*, American Shipper (Aug. 23, 2019), *available at* https://www.freightwaves.com/news/cma-cgm-will-not-ship-via-arctic-waters-as-part-of-green-pledge.

JOIN THE STATE BAR OF TEXAS INTERNATIONAL LAW SECTION FOR OUR ANNUAL TRIP!

Toronto, Canada

May 6-8, 2020

6 HOURS OF MCLE CREDIT - APPROVAL PENDING

Our Canada trip includes a reception and morning CLE programs followed by afternoon tours and dinners.

Many thanks to our Canadian Firm Partners **Fasken** and **Borden Ladner Gervais** for hosting our CLE sessions.

MAY 8 TOPICS:

- Foreign Investment and National Security Considerations in Cross Border M&A
- Minority Report: What Canada's Minority Parliament Means for Pipelines, Climate Change, and other Energy-Related Matters
- 21st Century Energy – Environmental and Social Considerations for an Energy Sector in Transition

MORE INFO / DETAILS:
ILSTEXAS.ORG/UPCOMING-EVENTS

INTERNATIONAL LAW SECTION
THE STATE BAR OF TEXAS

Canada-U.S. Trade: Looking Across the Northern Border

BY DOUG MCCULLOUGH,
McCullough Sudan, PLLC
and a director of the Canada-Texas Chamber of Commerce, Texas

Introduction

"We're more than friends and neighbors and allies; we are kin, who together have built the most productive relationship between any two countries in the world today."

– President Reagan, welcome ceremony remarks at the Shamrock Summit, Quebec City, March 17, 1985

Despite being one of our closest friends and neighbors, our biggest trade partner, and one of our staunchest military allies, we Americans tend to overlook the significance of our relationship with Canada. For better or worse, we sometimes think of Canada like our 51st state, when we think of it at all. The view from Canada is much different. Canadians are proud of their heritage and see their identity as distinct from the American one. They tend to be more aware of its reliance on international trade. On one hand this makes trade with the U.S. paramount for Canada; but it also means that Canada is sensitive about America's sometimes fickle disposition toward trade, particularly in the current political climate.

The Canadian Economy

Recently, the American Enterprise Institute prepared a U.S. map where each state was renamed for a country with a GDP of similar size. Texas was renamed Canada. Canada has a GDP approximately the same as Texas, but a reader should not misunderstand this as disparaging Canada. The Texas economy is large, and Texas is one of the nation's top producers and its leading exporter.

Canada has a diversified economy with $1.189 trillion GDP, which positions them as the tenth largest economy globally in terms of GPD size. Its top industries are the service industry (70% of GDP), energy sector (20% of GDP), and manufacturing industry (10% of GDP),with exports of over $350 billion, agriculture, and mining.

NAFTA: A North American Common Market

At the Shamrock Summit in Quebec City in March of 1985, Canadian Prime Minister Brian Mulroney and U.S. President Ronald Reagan began negotiations of a free trade agreement that would ultimately create a common market between the two nations. Its purpose was to reduce costs of trade, fuel economic growth, and make the U.S. and Canada more competitive globally. A few short years later, the free trade zone expanded when Mexico joined the North American Free Trade Agreement (NAFTA). It is estimated that about fourteen million American jobs depend

on trade with Canada and Mexico. Exports to Canada and Mexico make up 34% of all U.S. exports. But that doesn't tell the entire story, because the North American supply chain is so interconnected. American imports comprise about 40% of the value of imports from Mexico and 25% of imports from Canada.

Texas has arguably been the top beneficiary of NAFTA. Our top two trade partners are Mexico and Canada. Texas has a trade surplus with Canada, and according to some calculations, so does the U.S. Texas exports about $22.8 billion of goods annually to Canada, its second-largest trade partner (behind our neighbor Mexico). Trade and investment with Canada is directly responsible for over 459,700 Texas jobs, and Canada has made nearly $3 billion in inward investment into Texas. Texas manufacturers produced $227.46 billion of goods in 2015, making up 14.34% of total state output.

NAFTA Renegotiations – the USMCA

During his presidential campaign, Donald Trump declared NAFTA "the single worst deal ever approved." Upon taking office, President Trump set out to renegotiate the trade pact. Despite the fact that Canada is one of our staunchest military allies, bruising negotiations were conducted under the shadow of President Trump's tariffs on imports of Canadian steel and aluminum in the name of "national security."

After protracted negotiations, the U.S., Canada, and Mexico agreed to replace the NAFTA with the new United States-Mexico-Canada Agreement (USMCA) on November 30, 2018.

The United States-Mexico-Canada Agreement: NAFTA plus hints of TPP

On November 30, 2018, the U.S., Canada, and Mexico signed an agreement to replace NAFTA with USMCA. However, USMCA is not drastically different from NAFTA. In fact, many of the new provisions originated from the Trans-Pacific Partnership (known as TPP or CPTPP), from which President Trump withdrew shortly after his inauguration. Other, more protectionist, provisions were directed toward competition from lower cost automotive manufacturing in Mexico. Some of the key differences between NAFTA and the USMCA include:

- The USMCA requires that at least 40% of all automotive content be made by workers earning at least $16 an hour. The change is intended to prod domestic companies to relocate manufacturing in the U.S. by eliminating Mexico's main advantage in that area: lower labor costs.
- Mexico agreed to pass laws giving workers the right to union representation, to extend labor protections to migrant workers (who are often from Central America), and to protect women from discrimination.
- Under USMCA, a minimum of 62.5% of materials in a car or light truck manufactured in the NAFTA region must be from North America to avoid tariffs.
- Dairy exports from the U.S. to Canada may increase modestly. The U.S. achieved an estimated 0.34% more access to the Canadian dairy market than would have been available under TPP.
- Intellectual property protection, particularly for biological drugs, will be strengthened in Canada. This might mean higher prices for Canadians but also possibly greater access to new drugs.
- Canadian cultural regulations remain untouched. Whether they can be maintained in practice with the growth of internet broadcasting is an open question.
- USMCA did not directly require the U.S. to lift "national security" tariffs on steel and aluminum. However, the three parties also signed side letters to the USMCA concerning potential U.S. restrictions on automotive imports, pursuant to Section 232 of the Trade Expansion Act of 1962, and potential future Section 232 proceedings.

Though the changes from NAFTA were modest, USMCA was greeted by many economists and businesses as a welcome reprieve from the cross-border trade uncertainty that had accompanied the NAFTA renegotiations. However, as of this writing, the three signatory countries have yet to ratify. In the absence of the ratification of USMCA, NAFTA remains in effect, and it will remain so unless terminated by President Trump.

Competitiveness

When companies make strategic decisions about capital expenditures, site-selection, or entering new markets, they regularly consider the opportunities for growth, but also the comparative advantage of locations and jurisdictions. Below is a broad comparison of a few factors with respect to competitiveness.

Business Competitiveness: Economic Freedom

From an economic freedom standpoint, both the U.S. and Canada enjoy relative ease of doing business compared to other economies around the globe. Cato Institute (in conjunction with the Fraser Institute in Canada) ranks the U.S. and Canada, respectively, as the 5th and 8th

freest markets in the world.

Within the U.S., Texas is one of the most competitive states in terms of regulation, taxation, ease of doing business, and economic freedom. The state has a reputation of business-friendliness, with minimal state taxes and reasonable regulations. In recent years, we have seen many out-of-state companies move facilities and even headquarters to Texas from states with heavier tax and regulatory burdens.

Texas was ranked 5th for economic freedom among North American states and provinces according to a recent Economic Freedom of North America report published by the Fraser Institute. That same study ranks oil-rich Alberta as the top-ranking Canadian province in terms of economic freedom.

Tax Competitiveness

As the Fraser Institute wrote in 2018, "Canada has completely lost its business tax advantage over the U.S." thanks to the Tax Cuts and Jobs Act (TCJA). In 2018, the U.S. reformed the Internal Revenue Code and reduced corporate and individual tax rates. The TCJA reduced the corporate tax rate from 35% to 21% and repealed the corporate alternative minimum tax.

According to the Tax Foundation, the U.S. is ranked 21st globally for tax competitiveness and its corporate tax rate. It is one of the highest-ranking major economies.

By contrast, the nominal Canadian corporate income tax rate is 38%; however, after taking into account certain federal tax abatements and rate reductions, the statutory effective rate is roughly 26%. In addition, Canada imposes a federal goods and services tax that is similar to a value-added tax in the European Union, as well as a carbon tax. According to the Tax Foundation, Canada is ranked 15th overall, but 256th for corporate tax.

Immigration and R&D Cost

In addition to well-publicized efforts to crack down on unlawful immigration, the Trump administration is restricting legal immigration of workers. The denial rate for H1-B visas for first time employment in the U.S. rose dramatically from 6% in FY 2015 to 32% in the first quarter of 2019 according to the National Foundation for American Policy (NFAP).

Cities like Toronto are well-positioned to attract global talent. Toronto, North America's fourth largest metropolitan area, is already the home of Sidewalk Labs, an urban development subsidiary of Alphabet Inc. It also finished in the top 20 during Amazon's recent search for a new corporate headquarters. Canada's more welcoming immigration laws make Toronto an attractive alternative to American cities that may struggle to attract global talent due to federal immigration policies.

Canada: Vast Trade Treaty Network

Parting ways with prior administrations' expansion of multilateral trade agreements, the Trump administration has taken a bilateral, or even unilateral, approach to trade. The resulting uncertainty and trade skirmishes have made it difficult for corporate executives to make strategic and supply-chain management decisions. By contrast, Canada has a stable and growing network of treaties. These trade agreements grant Canada preferential access to 51 countries, which are populated by nearly 1.5 billion consumers and cover 62% of global GDP. Canada's vast trade treaty network is attractive to multinational corporations wishing to de-risk their global supply chain during the current instability in American trade policy.

Oil and Gas Investments

Both Texas and Alberta have much to boast about in oil and gas. Alberta boasts "the third largest oil reserves in the world, after Venezuela and Saudi Arabia." On the other hand, Texas is ranked fourth in oil production, and is closing in on third place globally. The difference is that Alberta struggles to get its oil out of the ground and move it to market due to strict environmental regulations and inadequate pipeline capacity.

As a result, in the recent "Canada-U.S. Energy Sector Competitiveness Survey 2019," the Fraser Institute ranked Texas as the most attractive place for oil and gas investment and found it twice as attractive as Alberta. Per the survey results, "Investors pointed to the uncertainty concerning environmental regulations, taxation, and regulatory duplication and inconsistencies as major areas of concern in Canadian provinces compared to U.S. states." The report continues on to say, "There are many potential reasons for investors to perceive Canada's investment attractiveness as declining. Some factors include insufficient pipeline capacity, the introduction of a carbon tax, Bills C-69 and C-48, and onerous regulations. Canada's recent policy and regulatory changes have been particularly damaging given that deregulation and sweeping tax reforms in the United States have significantly improved the business environment in that country, particularly for the oil and gas sector."

Canada's rising carbon tax may be another deterrent to oil and gas investment. In 2019, the tax started at $20 per ton of carbon that is released; however, it is set to reach $50 per ton in 2022.

Canada's regulatory regime and tax environment, along with a lack of adequate pipeline capacity has caused Canada Heavy Crude (WCS) to trade at a steep discount compared to West Texas

Intermediate (WTI), sometimes at as much as 60-70% discount. This environment has made the Alberta oil sands unattractive to capital investment.

Ease of Doing Cross-border Business

Thanks to proximity, a shared language, free-trade agreements, and similarities in our common law based legal systems, Canada and the U.S. have an integrated market. Compared to other countries, their legal systems are similar, and there is a sense of familiarity with business terms and legal concepts.

Nevertheless, it is a mistake to think that doing business in Canada is no different than conducting business in another state, such as Minnesota. When venturing into Canada, it will be necessary for American companies to retain Canadian counsel to advise on local law, particularly on the differences in tax law and employment law (which tends to be more progressive in Canada than in the U.S.).

When Canadian companies enter the U.S. market, they typically start by setting up a subsidiary. This allows them to ensure that the Canadian company and its shareholders can segregate their liabilities, avoid personal nexus in the U.S., and avoid inadvertently becoming U.S. taxpayers, while at the same time availing themselves of the U.S.-Canada tax treaty. As a caveat, there are certain tax pitfalls associated with Canadian companies and investors forming U.S. limited liability companies. For example, Revenue Canada does not recognize LLCs as separate entities, and as a consequence, LLCs do not qualify for the U.S.-Canada tax treaty benefits. It is typically advisable for Canadian investors to use C corporations or limited partnerships. Larger Canadian corporations might enter the U.S. market through a C corporation subsidiary. However, owners of Canadian SMEs may enjoy lower taxation overall using a Texas or Delaware limited partnership. The U.S. partnership will attract only one level of taxation (as a withholding to its non-resident partners), and the U.S. tax will be creditable against the partners' Canadian income tax. Tax is not the only factor to consider. Companies anticipating third-party investment should also factor in the choice-of-entity preferences of potential investors.

Despite occasional disputes and trade uncertainty, the shared commercial experience, geography, market integration, and general ease of doing cross-border business between Canada and the U.S. suggest that we will remain each other's chief trade partner for many years to come.

Doug McCullough | mccullough@dealfirm.com |Partner at McCullough Sudan, PLLC and director of the Canada-Texas Chamber of Commerce| Texas ■

Endnotes

1 Mulroney, Brian '*Brian Mulroney: U.S. actually enjoys $7.7B trade surplus with Canada under NAFTA*' (National post, January 30, 2018) https://nationalpost.com/opinion/brian-mulroney-nafta-isnt-just-another-trade-deal-its-a-model-for-the-world.

2 Top Trading Partners – September 2019 (United States Census, September 2019) https://www.census.gov/foreign-trade/statistics/highlights/toppartners.html.

3 Perry, Michael '*Column: Recommit to free trade in new NAFTA*' (Detroit News, July 15, 2017) https://www.detroitnews.com/story/opinion/2017/07/15/nafta-free-trade-canada-mexico-recommit/103725658/.

4 Texas Trade Statistics, (Global Edge, 2018) https://globaledge.msu.edu/states/texas/tradestats.

5 National Post, See above at 1; Sechler, Bob, '*Mexico trade deal called good for Texas, but Canada seen as important*' (Statesman, September 26, 2018) https://www.statesman.com/business/20180827/mexico-trade-deal-called-good-for-texas-but-canada-seen-as-important.

6 National Association of Manufacturers, State Manufacturing Data, https://www.nam.org/state-manufacturing-data/.

7 De Rugy, Veronique, '*Twenty-Five Years of NAFTA*' (Law & Liberty, January 2, 2019) https://www.lawliberty.org/liberty-forum/twenty-five-years-of-nafta/.

8 Story, Courtesy, '*NORAD 60th celebrates enduring partnership to defend North America*' (NORAD News, May 14, 2018) https://www.norad.mil/Newsroom/Article/1520570/norad-60th-celebrates-enduring-partnership-to-defend-north-america/.

9 Section 232 of the Trade Expansion Act of 1962.

10 United States-Mexico-Canada Agreement (Office of the United States Trade Representative) https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement.

11 Law Liberty, *supra* at 7.

12 *Fraser Institute Economic Freedom of the World 2019 Annual Report*, (Cato Institute, 2019) https://www.cato.org/sites/cato.org/files/pubs/efw/efw2019/efw-2019-chapter-1.pdf.

13 Stansel, Dean; Torra, Jose; McMahon, Fred, '*Economic Freedom of North America 2019*' (Fraser Institute, November 7, 2019).

14 Lammam, Charles and MacIntyre,

Hugh '*Canada has completely lost its business tax advantage over the U.S.*' (Fraser Institute, May 4, 2018) https://www.fraserinstitute.org/blogs/canada-has-completely-lost-its-business-tax-advantage-over-the-us.

15 Bunn, Daniel and Asen, Elke '*International Tax Competitiveness Index 2019*' (Tax Foundation, October 2, 2019) https://taxfoundation.org/2019-international-index/.

16 Pomerleau, Kyle '*The United States' Corporate Income Tax Rate is Now More in Line with Those Levied by Other Major Nations*' (Tax Foundation, February 12, 2018) https://taxfoundation.org/us-corporate-income-tax-more-competitive/.

17 *NFAP Policy Brief April 2019 H-1B Denial Rates: Past and Present* (National Foundation for American Policy, April 2019) https://nfap.com/wp-content/uploads/2019/04/H-1B-Denial-Rates-Past-and-Present.NFAP-Policy-Brief.April-2019.pdf.

18 *Oil Sands Facts and Statistics*, (Government of Alberta, 2019) https://www.alberta.ca/oil-sands-facts-and-statistics.aspx.

19 Bowden, John '*Texas set to pass Iraq, Iran as world's third-largest oil producer*' (The Hill, July 18, 2018) https://thehill.com/policy/energy-environment/397669-texas-set-to-pass-iraq-iran-as-worlds-third-largest-oil-producer.

20 Stedman, Ashley and Aliakbari, Elmira '*Canada-U.S. Energy Sector Competitiveness Survey 2019*' (Fraser Institute, 2019) https://www.fraserinstitute.org/sites/default/files/2019-canada-us-competitiveness-survey-execsummary.pdf.

21 Stedman, Ashley and Aliakbari, Elmira '*Canada-U.S. Energy Sector Competitive Survey 2019*) (Fraser Institute, 2019) https://www.fraserinstitute.org/sites/default/files/2019-canada-us-competitiveness-survey.pdf.

22 McKitrick, Ross; Aliakbari, Elmira; and Stedman, Ashley '*The Impact of the Federal Carbon Tax on the Competitiveness of Canadian Industries*' (Fraser Institute, 2019) https://www.fraserinstitute.org/sites/default/files/2019-canada-us-competitiveness-survey.pdf.

23 Aliakbari, Elmira and Stedman, Ashley '*The Cost of Pipeline Constraints in Canada, 2019*' (Fraser Institute, April 2019) https://www.fraserinstitute.org/sites/default/files/cost-of-pipeline-constraints-in-canada-2019.pdf.

24 Atlas, Michael '*LLC "Checking the Box" May Have Pitfall for Canadians!*' (Wolters Kluwer, September 18, 2018) https://wolterskluwer.ca/blog/llc-checking-box-may-pitfall-canadians/.

Keynote Speaker:

Randy Bagwell, U.S. Army Colonel (Ret) JD,LL.M. Senior Director, International Services, U.S. Programs, American Red Cross

Panel Topics:

- Data Privacy
- Sustainability in the 21st Century
- Blockchain
- Cryptocurrency
- Brexit
- Coverage of topics relevant in the Energy and Natural Resources, Hospitality, Manufacturing, Healthcare, and Employment industries.

INTERNATIONAL LAW SECTION
THE STATE BAR OF TEXAS

PRESENTED IN PARTNERSHIP WITH THE SMU ROWLING CENTER

REGISTER: ILSTEXAS.ORG/ UPCOMING-EVENTS

32nd Annual Institute

"At the Intersection of the Technology Revolution & Human Rights"

April 23-24, 2020

SMU CAMPUS
MARTHA PROCTOR MACK BALLROOM
(UMPHREY LEE CENTER)
3300 DYER STREET, SUITE 101
DALLAS, TX 75205

Registration information:

Before March 15, 2020

- Member ($200)
- Non-Member ($300)
- Student ($25)
- Council & Action Committee ($175)
- Government Agencies, Judges, New Attorneys (1-3 years) ($100)

After March 15, 2020

- Member ($275)
- Non-Member ($400)
- Student ($25)
- Council & Action Committee ($250)
- Government Agencies, Judges, New Attorneys (1-3 years) ($125)

Investing in Mexico using Canadian Partnerships? Beware of Mexico's 2020 Tax Reform.

BY FERNANDO JUAREZ, L.L.M.
International legal tax consultant at Cacheaux, Cavazos & Newton, L.L.P. (San Antonio, Texas)

MANUEL MARTINEZ ANZALDUA, ESQ.
Associate attorney at Cacheaux, Cavazos & Newton, L.L.P. (San Antonio, Texas)

Introduction

As a result of the North American Free Trade Agreement ("NAFTA"), investment among signatory countries is deeply interconnected and subject to continuous change. One of the most relevant topics of foreign investments relates to tax implications in international investments to achieve tax neutrality.

Investors use multiple tax structures to maximize tax benefits and corporate flexibility. Each structure is tailored to a different goal, whether that is reducing tax impact on investments, preserving the confidentiality of investors or simply investing in a jurisdiction with optimal corporate-governance laws and regulations.

In North America, a popular investment vehicle used by foreign investors is the Canadian limited partnership ("LP"). There are two main benefits arising from the use of Canadian LPs: pass-through tax treatment, and avoidance of disclosures for purposes of the Common Reporting Standard (the "CRS"). In addition, depending on the investor's investments, such structures using Canadian LPs can be optimal for purposes of international tax planning.

Given the most recent developments in the international tax arena led by the Organization for Economic Cooperation and Development (the "OECD") to tackle aggressive tax planning and crystallize the Base Erosion and Profit Shifting (the "BEPS") project, OECD and non-OECD members in Latin America have been implementing new standards within their domestic legislation to update old tax regulations. Among the three OECD members in LATAM (Argentina, Chile and Mexico), Mexico in particular has been a leader in the implementation of such reforms.

The 2020 Mexico Tax Reform is the latest act to update such international rules, and its impact on both foreign investment and the use of popular tax structures, like those using a Canadian LP,

will be palpable. This article discusses the tax benefits of using Canadian LPs by non-resident corporations domiciled in the U.S. and Mexico, as well as the future impact that the new Mexican legislation will have on these structures.

Current Tax Planning using Canadian Limited Partnerships

Overview

The following is a popular tax structure used when investing in Mexico: First, the investors pool investments through investment vehicles ("EV"), which are usually Canadian LPs; and thereafter, the EV places an investment in the target entity, such being the "operating business." To have a more insightful perspective on the current benefits of this kind of tax structure, we will analyze the generalities of Canadian partnerships, discuss what is a Canadian LP and summarize its tax benefits when investing in the U.S. and Mexico.

Corporate and Tax Features

Canadian LPs, as with other partnerships, exist solely due to a contractual relationship between its partners – not the "incorporation or formation" of such. As a result of this, and its pass-through tax treatment, a partnership is not deemed a separate legal entity from its partners. However, a partnership can hold assets under its name, among other common "corporate" features. Canadian legislation requires Canadian LPs to have at least one General Partner ("GP") and one or more limited partners. It is worth noting that these "creatures of contract" still have to make a filing with the Registrar.[1]

Canadian LPs are treated by the Income Tax Act of Canada (the "Act") as pass-through or "disregarded" entities for Canadian income tax purposes.[2] Any income or losses incurred by the partnership are allocated to the partners. Such allocations are made pursuant to the guidelines stipulated in the partnership agreement.

In a practical sense, income or losses are distributed directly to the partners so they can account for it in their taxable income. The accounting of such income or losses at the partner level allows a partner, when calculated in conjunction with other income or losses, to efficiently manage their overall tax burden. Tax-motivated investments have popularized the use of partnerships, specifically in cross-border transactions. In effect, this feature eliminates the "double-taxation" issues applicable to corporations. The second key benefit of a partnership is the flexibility provided for in its partnership agreement.[3] Flexibility is beneficial primarily because investors can use the partnership agreement to carefully tailor and draft any allocations of income.

Among their other benefits, Canadian LPs have been favorably adopted in cross-border corporate structures due to domestic and Canadian income tax treatments.

To put all of these benefits in context, let's review a common cross-border structure, taking into consideration the current Canadian and U.S. legislation. First, U.S. individual(s), aided by attorneys and CPAs, shall determine the optimal entities to serve as GP and limited partner(s) of a Canadian LP. This stage of the planning process is essential since the entity serving as general partner will: (i) operate the day-to-day business transactions on behalf of the Canadian LP; and (ii) subject itself to unlimited liability for acts or omissions caused by it on behalf of the Canadian LP. Second, once the GP and limited partner(s) have been determined, then the representatives of these entities shall discuss the partnership agreement. Specifically, such representatives shall discuss any allocation and distribution provisions in the Canadian LP's partnership agreement. In today's world, when not all partners are contributing capital in kind, these provisions are crucial to a GP's or limited partner's flexibility and success.

After the partnership agreement has been ironed out and executed, the corporate structure is deemed complete. From the date of execution, entities serving as GP and limited partner(s) can take advantage of the pass-through partnership taxation and the flexibility offered in its distributions (i.e., income or losses). This simple yet advantageous cross-border structure has proliferated among North American businesses due to the benefits explained above. The elimination of corporate taxation, flexibility on distributions, and limitation of the partner's liability have been drivers to the Canadian LP's success.

As discussed, the benefits for tax purposes offered by Canadian LPs are highly attractive for cross-border investment. The same is true for multinationals and private equity companies investing in Mexico. The cross-border structure when investing in Mexico is identical to the structure previously analyzed. The investor(s) will determine which entity will act as a GP and limited partner(s) in order to allocate income and losses which will be directly attributed to the partners.

The use of a Canadian LP has been remarkably advantageous for foreign investors, especially when investing in Mexico. To recapitulate, this tax structure allows investors to pool their money in an EV located in Canada, a jurisdiction with strong corporate-governance regulations, while at the same time achieving asset protection liability; Second, returns that are not source-based in Canada flow directly to the Canadian LP's partners, given its pass-through treatment.

An additional benefit is in relation to reporting purposes, specifically for CRS purposes. Because the Canadian LP is given a pass-through treatment, the reporting obligations hinge on the effective place of management's location. If such place of management is deemed

to be situated in Canada, the Canadian LP is considered to be a resident for reporting purposes and is thereby subject to reporting. If the effective place of management is located outside Canada, then the opposite is true.[4] Investments made in Mexico frequently fall in the second category and, hence, are not reportable for CRS purposes in Canada.

Future Tax Planning when using Canadian Partnerships

Overview of the 2020 Mexican Tax Reform

On September 2019, Mexico's newest administration introduced a bill to Congress with the intent to amend various federal tax laws currently in place. The bill was approved by the House of Representatives and the Senate and is now waiting its official publication by the Executive Branch. Such publication took place before the end of 2019. The changes implemented by the Tax Reform became effective January 1, 2020.[5]

Among other tax laws being amended, one of the most relevant changes are those being made to the Income Tax Law (ITL). Mexico's reform includes new provisions that implement BEPS measures to tackle aggressive tax planning, such as those provided by: Action 2 (concerning hybrids mismatch arrangements); Action 3 (relative to CFC rules); and Action 5 (related to the tax treatment of transparent entities).

The implementation of these rules will greatly impact the previously discussed tax structures involving Canadian LPs in the following manner.

New Rules for Disregarded Entities

The Mexican tax reform incorporates a new rule preventing excessive use of disregarded entities. Beginning on January 1, 2020, any non-Mexican "persons" considered as pass-through entities will be deemed to be a separate taxable entity for Mexican purposes.[6]

For purposes of this new rule, "person" includes entities that are deemed a separate legal entity (e.g., a corporation) as well as those that are not (e.g., joint venture, partnerships).

Rules provide that a foreign entity or "person" is deemed disregarded if: (i) the entity is not a tax resident for income tax purposes in the jurisdiction of incorporation or where effective place of management is located; and (ii) its owners receive any income attributed to the entity.

> "The use of a Canadian LP has been remarkably advantageous for foreign investors, especially when investing in Mexico."

Under this new rule, a Canadian LP originating non-Canadian sourced income is deemed as a foreign disregarded entity, since it is not a tax resident for Canadian purposes and the income attributed to such Canadian LP is allocated to its partners.

If this rule applies, foreign investors will be subject to withholding requirements. In our example, any income received by the Canadian LP from a Mexican investment will be subject to a withholding on any distribution(s). For example, an interest payment from the Mexican investment to the Canadian LP may be subject to a maximum withholding of 35%. However, the Canada and Mexico tax treaty provides for preferred tax withholding rates.[7] Despite preferred treatment, the withholding on repatriation payments from the Mexican investment impacts the effective tax rate on the investment.

Greater complications arise in those cases when the GP is a Mexican tax resident, and consequently the effective place of management is in Mexico. If such is the case, a new rule in Mexico establishes that the foreign disregarded entity, in this case the Canadian LP, will be deemed a Mexican tax resident for Mexican tax purposes. As a consequence, the Canadian LP would account for its gross income on a worldwide basis, notwithstanding the location of the investments.

If the Canadian LP has permanent establishment activity in any other jurisdiction, income obtained through such PE will also be included in its gross income and the Canadian LP would pay taxes in accordance to Mexican tax regulations. The tax consequences of this last hypothesis are blurry, given the existence of tax treaties, which will prevent the applicability of this new rule for the payment of attributed to double taxation, in cases where the foreign transparent entity includes as gross income the income derived from other jurisdictions.

Reporting Disclosure

The 2020 Mexico Tax Reform also introduces a mandatory disclosure regime for any transaction or arrangement that provides a tax benefit in Mexico, notwithstanding the tax residence of the taxpayer. The Federal Tax Code provides a list of transactions that are subject to reporting, including those transactions that exchange tax or financial information, including reporting for CRS purposes.[8]

This is relevant for those Canadian LPs whose GP is a Mexican tax resident. Under Canadian legislation, in cases of disregarded entities, the entity is treated

as a resident in the jurisdiction in which it has its effective place of management for CRS reporting purposes. If the GP is in Mexico, it is understood that the effective management of such partnership is in Mexico, making such Canadian LP a resident for reporting purposes. In other words, the Canadian LP is considered as managed effectively in Mexico, thereby eliminating any Canadian reporting obligations.

With the 2020 Mexico Tax Reform, such structure will bring a reporting obligation under Mexican Law. Because such structure prevents reporting for CRS purposes in Canada, in accordance to the new mandatory disclosure regime, the GP located in Mexico would need to report the structure involving the Canadian LP. This may not sound highly relevant, but it in fact is. The disclosure of information may allow the tax authorities to analyze the transactions being carried out by the taxpayer, and more importantly may lead to an analysis related to transfer pricing and eventually to a tax controversy. Additionally, penalties may be imposed to the GP for not disclosing these arrangements.

Conclusion.

Considering the discussed consequences of the 2020 Mexico Tax Reform, it will be important to analyze the tax structures involving a Canadian LP to avoid any surprise given the new tax changes in Mexico. In cases where the GP is a Mexican tax resident, it will also be relevant to analyze amending the structure to prevent an undue taxable presence in such jurisdiction. ■

Endnotes

1 Gillen, Mark. "Corporations and Partnerships in Canada, Third edition." Kluwer Law International, 1082-1083.

2 Elizabeth J. Johnson and Genevieve C. Lille. "The Taxation of Partnerships in Canada." Bulleting for International Taxation, Wilson & Partners, LLP, 381.

3 Westaway, Patrick. "Structuring Entry into the Canadian Market: A Corporate Tax Primer." Dale & Lessmann, LLP, 7-8.

4 Canadian Income Tax Act, Part XIX. R.S.C., 1985, c. 1 (5th Supp.)

5 Bill to amend the Mexican Income Tax Law, Value Added Tax Law, the Special Tax Law on Products and Services, including amendments to the Federal Tax Code. Introduced by the Executive on September 8, 2019 ("The Bill").

6 New article 4-A of the Mexican Income Tax Law as amended by The Bill.

7 Article 11 of the United States-Mexico Income Tax Convention.

8 New article 197 of the Mexican Income Tax Law as amended by The Bill.

STATE BAR OF TEXAS INTERNATIONAL LAW SECTION PRESENTS

THE SEVENTH ANNUAL INTERNATIONAL LAW SEMINAR & NETWORKING LUNCH

Theme: Trade Law and Regulations

THURSDAY, FEBRUARY 27, 2020

11:30AM-3:45PM | LUNCH PROVIDED

GREAT HALL AT VENTANA BY BUCKNER

8301 N. CENTRAL EXPRESSWAY| DALLAS, TEXAS 75225

3 HOURS OF MCLE CREDIT – APPROVAL PENDING

REGISTER: ILSTEXAS.ORG/UPCOMING-EVENTS

PRESENTED IN PARTNERSHIP WITH

INTERNATIONAL LAW SECTION
THE STATE BAR OF TEXAS

BUCKNER
Hope shines here.

McGINNIS LOCHRIDGE

POLSINELLI

Major Regulatory Changes under USMCA

BY ADRIENNE BRAUMILLER
Founding Partner, BLG

The long-awaited implementation of the new United States-Mexico-Canada Agreement ("USMCA") should be happening sometime next year. The USMCA will modernize an outdated NAFTA that went into effect on January 1, 1994. The purpose of the new USMCA is to continue to support a free market and fair trade between the United States, Canada, and Mexico while modernizing the agreement to incorporate new technology and current trade trends. The changes between NAFTA and the USMCA will impact multiple industries, but probably none more than the automotive industry.[1] This is due in no small part to the USMCA's inclusion of a new Labor Value Content ("LVC") rule, and its changes to the regional value content and country of origin rules. This article provides an overview of those additions and culminates with general things for companies in the affected industries to consider.

Introduction of the Labor Value Content Rule

The USMCA introduces a LVC requirement, which makes the automotive trade, for the first time, subject to minimum-wage requirements.[2] This means that in order to qualify for preferential treatment, at least 40% of the value of passenger cars and 45% of the value of light trucks must be produced in North American facilities where workers make an average of $16 per hour.[3] The intended effect of such a requirement is to nudge automakers to invest in parts production in the United States and Canada.[4] But the requirement could have the opposite effect: the auto industry could elect to accept the USMCA's penalties for not complying with the LVC rule and move production to Mexico altogether. Mexico's lower wages have long allowed the country to enjoy a comparative advantage in the auto industry, which has, in turn, driven investment in that industry. Accordingly, companies in the automotive industry should keep the costs of labor in mind as they prepare for the USMCA to go into effect.

Changes to Regional Value Content Rule

The USMCA also brings significant change to the auto industry by setting higher regional value content ("RVC") thresholds for the sector.[5] The regional value content of a good is a rule of origin. It helps to determine the country of origin of a specific good and, consequently, whether the good enjoys preferential treatment—here, under the USMCA. For example, the RVC for passenger vehicles and light trucks is now 75% under USMCA; under NAFTA, 62.5%. Along the same lines, the RVC for principal parts and complementary parts under the USMCA increased to 70% and 65%, respectively. By contrast, NAFTA maintained lower RVC thresholds—of approximately 60%—for those items. At least in the United States, the higher RVC thresholds are being justified by reference to the economic benefits they are projected to bring. Still, it is difficult to overlook that this comes at the cost of less efficient and less established supply chains (and even more onerous regulatory burdens).[6] Admittedly, the USMCA's RVC thresholds will not go into effect immediately; light vehicles and trucks will enjoy a three-year transition period, and heavy trucks a seven-year phase-in period.[7] That said, the USMCA's RVC thresholds are the most stringent automotive rules of any trade agreement to date.[8] The automotive industry would do well to think through what compliance for its companies will look like under the USMCA.

Changes to Country of Origin Requirements

The USMCA will also change multiple provisions that affect Country of Origin ("COO") requirements.[9] First, the USMCA

eliminates provisions relating to the COO marking rules currently found codified in Part 102 of Title 19 of the Code of Federal Regulations.[10] That change is significant, but not unwelcome. Put plainly, goods will no longer have to be analyzed under two sets of rules, as was the case with the NAFTA Marking Rules. Second, the USMCA modifies the requirements for certificates of origin by allowing importers, producers, and exporters to complete the certificate of origin, so long as the individual completing the certificate has sufficient documentation to indicate where the good is originating.[11] Under the USMCA, moreover, there is no necessary format for the certificate to take, meaning that the data elements that indicate the good is both originating and meets the USMCA requirements may be provided on an invoice or any other document.[12] This again represents a major break from NAFTA, which requires a specific NAFTA certificate form to be validated at the time of entry. At first blush, this change makes it easier for more parties to certify that goods qualify under the USMCA. But it may also make it more difficult to spot deficient or invalid claims due to the use of varying templates or disparate forms. Finally, USMCA increases the de minimis threshold for non-originating content from 7% to 10%. While there are some exceptions, a good will now qualify as originating if the value of all non-originating material is not more than 10% of the transaction value or total cost of the goods.

General Considerations for Industries Affected by the USMCA

The regulatory changes under the USMCA can have a significant effect on businesses. Therefore, businesses should dedicate time to understanding how the changing regulatory landscape under the USMCA will affect their respective industry. Both U.S. importers and exporters should, for example, review specific origin rule changes on a product-by-product basis to determine whether there are any differences between NAFTA and the USMCA. Further, if a company is involved in the automotive industry, it may be required to source more of its products from the United States in order to meet higher RVC requirements. Likewise, a company with a manufacturing facility in Mexico may be required to increase its current labor rates to meet the new LVC requirements.

Conclusion

The International Trade Commission recently released a report that estimated that the USMCA would raise U.S. real GDP by $68.2 billion and U.S. employment by 176,000 jobs.[13] The report also estimated that U.S. exports to Canada would increase by $19.1 billion and to Mexico by $14.2 billion, while U.S. imports from Canada would increase by $19.1 billion and from Mexico by $12.4 billion.[14] As such, now is the time to review the new USMCA rules and evaluate any internal changes that need to be made. Companies should begin updating their compliance policies and procedures so that when the USMCA is enacted, there are no surprises. As an added measure, businesses should begin training key personnel on the various nuances of the USMCA to ensure that they remain compliant through the transition period.

For any additional inquiries, or if you would like to discuss the USMCA in more detail, please contact Adrienne Braumiller at Adrienne@braumillerlaw.com.

●●●

Adrienne Braumiller is the founder of Braumiller Law Group PLLC and an innovative force in the international trade law arena. With more than 25 years of experience, she is widely recognized as a leading authority in Customs, import, export, foreign-trade zones, free trade agreements and ITAR compliance. ■

Endnotes

1 *See* William A. Reinsch et al., *The Impact of Rules of Origins on Supply Chains: USMCA's Auto Rules as a Case Study* (April 2019).
2 *See id*; see also Tori K. Whiting and Gabriella Beaumont-Smith, The Heritage Foundation, *An Analysis of the United States-Mexico-Canada Agreement*, 11 (2019).
3 *See* Reinsch et al., *supra* note 1, at 1. This labor requirement means that the Department of Labor may be called into USMCA audits or verifications to ensure that this wage amount has in fact been met.
4 *See* Reinsch et al., *supra* note 1, at 11.
5 U.S. Int'l Trade Comm'n, TPA 105-003, 4889, U.S.-Mexico-Canada Trade Agreement: Likely Impact on the U.S. Economy and on Specific Industry Sectors 233-34 (2019) [hereinafter Likely Impact of USMCA].
6 *See* Reinsch et al., *supra* note 1, at 11.
7 *See id*. at 19.
8 *Id*.
9 Agreement between the United States, the United Mexican States, and Canada, Dec. 13, 2019, *available at* https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement/agreement-between [hereinafter USMCA].
10 *See* 19 C.F.R. § 102.20 (2018).
11 USMCA, Ch. 5 Origin Procedures.
12 *Id*.
13 *See* Likely Impact of USMCA at 14.
14 *Id*.

International Human Rights Day Recognized

BY TOM WILSON
Vinson & Elkins, Houston

On December 10, 2019, International Human Rights Day, the ILS and the International Human Rights Committee of the State Bar of Texas (IHRC) recognized the day with an event at the offices of Vinson & Elkins in Houston. Earlier in the day, the City of Houston and its Mayor, Sylvester Turner, recognized the ILS and the IHRC in a proclamation. The proclamation was read by the Mayor during an open meeting of the Houston City Council. Many members of the ILS and the IHRC, including several speakers for the event, attended the Council meeting. Both Mayor Turner and several Council members had very complimentary


Proclamation

State Bar of Texas – International Human Rights Committee and International Human Rights

State Bar of Texas – International Human Rights Committee and International Human Rights Day

comments on the ILS, the IHRC, and the job that was generally being done to recognize the importance of international human rights in the state of Texas. Similar proclamations were also issued on the same day in Dallas and Austin.

That afternoon, the event itself kicked off with a keynote speech by Edie Hofmeister, the former Executive Vice President, Corporate Affairs and General Counsel, for Tahoe Resources, Inc. Ms. Hofmeister addressed the operational challenges that Tahoe faced in its operations in Central America and the interplay between those operations, challenges, and international human rights.

The event concluded with a panel discussion by Chris Georgen, CEO and Chief Architect for Topel, Jennifer Hohman, Chief Information Officer and Vice President of Sea Drill Management, Ltd., Daniel Rey, Senior Vice President, Global Downstream, Nalco Champion, and Marion Werkheiser, Managing Member, Cultural Heritage Partners. The panel was moderated by Tom Wilson, Partner at Vinson & Elkins and Immediate Past Chair of the ILS. ■

Navigating Blockchain, Cryptocurrency and Smart Contracts: Legal Issues in An International Setting

BY AARON WOO
McCullough Sudan PLLC

September 23, 2019
Austin, Texas

In September of 2019, the ILS hosted a CLE Event in Austin, TX that was presented by a panel of specialized experts who shared a variety of perspectives on cutting-edge technology regulated by an ever-evolving body of law pertaining to the use of blockchain, cryptocurrency and smart contracts in the next frontier of the Internet.

On the panel, Eugene Kesselman, the CEO of TapJets (the Uber of Private Jets, which uses blockchain technology to track its flights) taught us the current state of the various technologies and what he foresaw to be the growth of new markets and industries. Alfonso Monroy, General Counsel of Bitso (Mexico's leading cryptocurrency exchange), shared with us the licensing and regulatory requirements of trading and transacting with digital currencies. Daniel Wood, Senior Associate at Pillsbury, discussed issues pertaining to money transmission and the regulation of cryptocurrencies. Aaron Woo, Partner at McCullough Sudan, moderated the panel, steering discussion of the topics and issues shaping the Global Digital Economy.

A great turnout of attorneys from all over the world were in attendance, including practitioners from Mexico City and the Hague. From the Q&A, many of the attorneys had similar questions or had identified some common issues that need to be examined in greater detail as this body of law evolves. As this area of international digital commerce matures, the ILS has the potential to influence and innovate this area of law to make Texas a pioneer in the next generation of the global economy. ■

Due Diligence for Political and Trade Risk

Considerations for North American Cross-border Transactions

BY DOUG MCCULLOUGH
McCullough Sudan PLLC

On November 30, 2018, the United States, Canada, and Mexico agreed to replace the North American Free Trade Agreement ("NAFTA") with the United States Mexico Canada Agreement ("USMCA"). The new agreement has been marked by fraught negotiations provisions, resulting in a heightened sense of trade uncertainty for the middle market. In the past, President Trump had threatened to pull out of NAFTA if USMCA were not ratified. Doing so would have left North America without a trade agreement, thereby creating tremendous uncertainty and instability.

At the time of this writing, it appears that Congress is on the brink of ratifying USMCA. The new USMCA still largely resembles NAFTA and includes positive elements drawn from the Trans-Pacific Partnership ("TPP"). While the USMCA has drawn criticism for constraining[1] rather than promoting trade, the ratification of the treaty has largely been welcomed for dispelling recent uncertainty about the future of trade with Mexico and Canada.

Trade Risk

Keeping a trade treaty in place not only facilitates trade throughout North America but should also facilitate cross-border acquisitions and dispositions as well as due diligence. In the absence of a trade agreement, corporate buyers and private equity investors would have to consider their exposure to tariffs, quotas and other trade restrictions that might reduce demand, disrupt supply chains and impact consumer goodwill. Each of these has the potential to impact future enterprise value for buyers and negatively affect any earn-outs for sellers.

The ratification of USMCA does not remove all trade risk. For instance, buyers in the automotive industry must be mindful that USMCA made significant changes to labor standards and rules-of-origins in the automotive industry that might increase Mexican labor costs and reduce demand for Mexican inputs into North American supply chain.

Political Risk

Understanding the political climate and pending litigation related to relevant industries is critical for any corporate buyer or investor considering an acquisition in a foreign country. This

remains true of Mexico and Canada despite the passage of USMCA.

Doing business and investments in Mexico continues to involve significant political risk. The election of Andrés Manuel López Obrador (AMLO) as president of Mexico has marked a rise of leftist-populism that is less than hospitable to foreign corporate investment.[2] In particular, the AMLO government is reversing the liberalization in recent years of the Mexican oil and gas sector.[3] Also, the rise in cartel violence in Mexico has led the Trump administration to threaten to name drug cartels as terrorist organizations.

Canada is not without political risk, as anyone in the oil sands can attest. Despite having some of the most extensive oil reserves in the world, the oil industry in Alberta is hampered by environmental restrictions, a carbon tax that disincentivizes investment, and most importantly, endless delays in permitting and construction of pipelines necessary to move product to refineries and consumers. And as the recent SNC-Lavalin political scandal has shown, concerns about foreign corrupt practices can happen to multinationals regardless of where they are headquartered.[4]

> “Canada is not without political risk, as anyone in the oil sands can attest.”

In Summary

Making decisions on acquisitions, capital expenditures, and plant construction often rests on the reliability of long-term financial forecasting. Thankfully, the ratification of the USMCA will dispel much of the trade uncertainty within North America during the past two years. This will not eliminate the need for trade risk due diligence but will make that due diligence more manageable. Nevertheless, political risk remains. Political instability and rising cartel violence in Mexico and a hostile regulatory environment and restricted pipeline capacity in the Canadian oil and gas sector demand thorough due diligence south of the border and in places such as the Canadian oil sands.

●●●

Doug McCullough, is a corporate lawyer at the Texas law firm McCullough Sudan, PLLC and a director of the Canada-Texas Chamber of Commerce. ■

Endnotes:

1 “Five Flaws in the USMCA and How to Fix Them,” Jeffrey J. Schott, The Peterson Institute for International Economics Trade and Investment Policy Watch, August 6, 2019

2 “Government Rift Deepens Mexico’s Economic Crisis,” Foreign Policy, by Keith Johnson, July 10, 2019

3 “Mexico Tries to Turn Back the Clock on Energy,” Foreign Policy, by Keith Johnson, October 4, 2019

4 “What you need to know about the SNC-Lavalin affair,” CBC, Frank Gollom, February 13, 2019

Proposed Regulations Set to Expand Authority of CFIUS

BY OLGA TORRES
Managing Member, Torres Law

MARIA ALONSO
Associate, Torres Law

Introduction: New Regulations

On September 7, 2019, the U.S. Department of the Treasury ("Treasury") issued two proposed rules that would expand the jurisdiction of the Committee on Foreign Investment in the United States ("CFIUS").[1] The proposed regulations are implemented pursuant to the Foreign Investment Review Modernization Act of 2018 ("FIRRMA"), which was signed into law in August 2018. If enacted, these new proposed regulations could have major implications on foreign investment and real estate transactions in the United States, and investors and companies must be aware of such potential impact.

Prior to FIRRMA, CFIUS's authority included reviewing transactions that could result in the foreign control of a U.S. business. FIRRMA, which received bipartisan support in Congress, significantly expanded CFIUS's authority. Notably, under FIRRMA, CFIUS is still authorized to review the "covered control transactions" but now also has jurisdiction over non-controlling investments in certain U.S. businesses and certain real estate transactions. The first set of proposed rules[2] would amend and expand CFIUS's existing regulations at 3 C.F.R. Part 800, which include changes related to controlled investments, foreign investments in U.S. businesses involved in critical infrastructure sectors, and those that hold sensitive personal data of U.S. citizens. The second set of proposed rules[3] would create a new set of regulations at 31 C.F.R. Part 802, which implement CFIUS's new jurisdiction over certain real estate transactions.

Final regulations implementing FIRRMA will formally take effect by February 2020. The October 2018 interim regulations for the existing Critical Technologies Pilot Program ("Pilot Program") were not changed by the proposed regulations. For more information about FIRRMA and the Pilot Program, please see our previous article published in this Newsletter last year.

FIRRMA and the proposed regulations expand CFIUS's jurisdiction based on two new grounds: 1) certain non-controlling investments in certain U.S. businesses involved with critical technology, critical infrastructure, or sensitive personal data, referred to as "TID U.S. businesses" for technology, infrastructure, and data; and 2) certain real estate transactions. The comprehensive proposed regulations provide detailed criteria that would trigger U.S. businesses or real estate transactions to fall under the purview of CFIUS's jurisdiction. Both proposed frameworks are addressed below, with a particular focus on non-controlling investments and real estate transactions involving property within a certain proximity to specified sensitive sites.

Non-Controlling Investments: From Control to Involvement

The nature of the investment and the nature of the target TID U.S. business are key to determining whether a certain non-controlling investment will fall under CFIUS's jurisdiction. The nature of the investment was promulgated in FIRRMA—the investment must afford a foreign person[4] at least one of the following: 1) access to material non-public technical information in the possession of the TID U.S. business; 2) membership or observer rights on the board of directors or equivalent governing body of the TID U.S. business, or the right to nominate an individual to a position on the board of directors or equivalent governing body of the TID U.S. business; or 3) any involvement (other than through voting of shares) in substantive decision-making of the TID U.S. business regarding certain actions related to sensitive personal data, critical technologies, or critical infrastructure.[5]

Furthermore, the nature of the target TID U.S. business is further defined in the proposed regulations. The three categories of TID U.S. businesses include:

1.) Critical Technology TID U.S. business is one that produces, designs, tests, manufactures, fabricates, or develops a critical technology;[6]
2.) Critical Infrastructure TID U.S. business is one that owns, operates, manufactures, supplies, or services the subset of 28 types of critical infrastructure identified in Appendix A. Some of these include telecommunications, utilities, energy, and transportation; and
3.) Sensitive Personal Data TID U.S. business is one that maintains or collects sensitive personal data of U.S. citizens, which may be exploited in a manner that threatens national security. The proposed regulations provide two types of sensitive personal data: a) "identifiable data," including data related to financial, geolocation, and health, among others, but only if the "category" and "collection" requirements are met (there are ten "categories" and three "collections"); and b) "genetic information" as defined in 45 C.F.R. § 160.1 03.

> "By expanding CFIUS's authority through these new proposed regulations, Treasury is increasing its role in national security matters as it relates to foreign investment and real estate transactions."

Excepted Investors

The proposed regulations do provide an exception from "covered investments" for certain foreign persons defined as "excepted investors" who will receive preferential treatment for having ties to certain countries identified as "excepted foreign states," and their compliance with certain laws, orders, and regulations (including U.S. export controls and sanctions).[7] The proposed regulations do not list any countries, and CFIUS has yet to publish a list of the countries that would be included within the "excepted foreign states." Importantly, this exception does not apply to control transactions (e.g., foreign control of a U.S. business).

Furthermore, proposed § 800.220 sets out the complex criteria that a foreign person needs to meet to be an "excepted investor," which is not determinative on the foreign person's nationality. Even if a foreign person meets the "excepted investor" criteria, the foreign person may lose their excepted status if, among others, the foreign person or related entities:

1.) violated U.S. sanctions laws or received a civil monetary penalty from the Office of Foreign Assets Control ("OFAC");
2.) entered into a settlement agreement with OFAC or the Commerce Department, Bureau of Industry & Security ("BIS");
3.) were debarred by the State Department, Directorate of Defense Trade Controls; or 4) are listed on the BIS Unverified List or Entity List.[8] It is evident that the proposed regulations significantly impact foreign; or
4) companies that violate U.S. sanctions and export control regulations.

Mandatory Filings

Another key aspect of FIRRMA and the proposed regulations is that CFIUS filings remain primarily voluntary. There are two types of transactions that trigger the mandatory declaration requirement:

1.) certain covered control transactions or covered investments in certain U.S. businesses involved with critical technologies, pursuant to the Pilot Program that went into effect in November 2018; and
2.) the covered transactions where a foreign government has a substantial interest in a TID U.S. business.

Under both the Pilot Program and the proposed regulations, parties can fulfil the mandatory declaration requirement by filing the "short-form" declaration or the full notice in lieu of the declaration.

Real Estate Transactions: Proximity to Sensitive Locations

FIRRMA and the proposed regulations also make clear that, in the eyes of CFIUS, real estate transactions that involve foreign parties can also be a matter of national security. As a result, foreign real estate investors looking to buy or lease property in the United States must be aware of these rules and how to effectively comply with them.

The proposed regulations regarding certain real estate transactions are found at 31 C.F.R. Part 802, which apply to "covered real estate transactions" defined as "the purchase or lease by, or a concession to," a foreign person of "covered real estate,"[9] either directly or indirectly, that affords the foreign person certain property rights, and that do not fall within the seven "excepted real estate transactions." The "covered real estate transactions" include transactions in or around sensitive sites such as specific airports, maritime ports, and military installations. The airports and maritime ports are identified on lists published by the U.S. Department of Transportation, and the military installations are listed at Appendix A to Part 802.

Moreover, the proposed regulations focus on real estate properties located within:

1.) "close proximity" (one mile) of any military installation identified in parts 1 and 2 of Appendix A;
2.) the "extended range" (between one mile and 100 miles) of any military installation enumerated in part 2 of Appendix A;
3.) the 24 counties or geographic areas associated with missiles fields listed in part 3 of Appendix A; and
4.) the 23 off-shore range complexes and operating areas, located within 2 nautical miles of the U.S. coastline and listed in part 4 of Appendix A.

The proposed regulations provide seven exceptions in § 802.217, which include transactions:

1.) by certain "excepted real estate investors" based on their ties to "excepted real estate foreign states";
2.) covered real estate transactions not already covered under CFIUS's jurisdiction pursuant to 31 C.F.R. Part 800 (e.g., control transactions and non-controlling investments involving TID U.S. businesses);
3.) real estate in an "urbanized area" or "urban cluster," unless it is in "close proximity" to a military installation listed on part 1 or 2 of Appendix A, or located within, or will function as part of, an airport or maritime port;
4.) single housing units;
5.) retail establishments at airports or maritime ports;
6.) commercial office space within a multi-tenant commercial office building; and
7.) certain lands owned by Alaska Natives or held in trust by the United States for American Indians, Indian tribes, Alaska Natives, and Alaska Native entities.

Under the new proposed regulations, real estate transactions, unlike certain covered non-controlling transactions mentioned above, do not require a mandatory filing. Parties subject to a "covered real estate transaction" can decide to file a voluntary notice or submit the "short-form" declaration to CFIUS. It is important for parties to keep in mind that certain real estate could fall under CFIUS's jurisdiction under Part 800, which trigger the mandatory declaration filing requirement.

Conclusion

By expanding CFIUS's authority through these new proposed regulations, Treasury is increasing its role in national security matters as it relates to foreign investment and real estate transactions. The potential effects of these new proposed rules remain uncertain moving forward. Could these changes lead to a decline in foreign investment in the United States? According to the Secretary of the Treasury, the proposed rules are aimed at better addressing national security concerns and provide "clarity and certainty" as to the role of CFIUS, but do not discourage investment in the United States. [10] Such an intention may be true, but until the new proposed rules are implemented, the future role of CFIUS and its impact on foreign investment in the United States remains to be known.

●●●

Olga Torres is the Founder and Managing Member of Torres Law, an International Trade and National Security Law Firm. Ms. Torres handles notable international trade matters for numerous companies worldwide and specializes in the areas of U.S. customs, exports, economic sanctions, anti-corruption compliance, and industrial security matters.

Maria Alonso is an Associate at Torres Law, an International Trade and National Security Law Firm. Ms. Alonso assists clients with a broad range of international trade regulatory matters, including export controls governed by the International Traffic in Arms Regulations (ITAR) and the Export Administration Regulations (EAR), industrial national security matters, economic sanctions, and U.S. customs laws and regulations. ■

Endnotes

1 The proposed rules were published in the Federal Register on September 24, 2019.

2 Provisions Pertaining to Certain Investments in the United States by Foreign Persons, 84 Fed. Reg. 50,174 (Sept. 24, 2019) (to be codified at 31 C.F.R. pt. 800) [hereinafter *Covered Investments Regulations*].

3 Provisions Pertaining to Certain Transactions by Foreign Persons Involving Real Estate in the United States, 84 Fed. Reg. 50,214 (Sept. 24, 2019) (to be codified at 31 C.F.R. pt. 802) [hereinafter *Real Estate Investments Regulations*].

4 As discussed below, the proposed regulations provide certain exceptions for an "excepted investor."

5 *See* § 800.211 in the *Covered Investments Regulations*, 84 Fed. Reg. at 50,185-86.

6 The proposed regulations do not change the existing Critical Technologies Pilot Program under 31 C.F.R. Part 801. In brief, "critical technologies" is defined to include five categories, related to certain items subject to export controls and other regulatory schemes, and emerging and foundational technologies controlled under the Export Control Reform Act of 2018.

7 *See* §§ 800.219 and 800.220 in the *Covered Investments Regulations*, 84 Fed. Reg. at 50,186-87.

8 *See* § 800.220 in the *Covered Investments Regulations*, 84 Fed. Reg. at 50,187.

9 "Covered real estate" is defined in § 802.211 and Appendix A to Part 800 in the *Real Estate Investments Regulations*, 84 Fed. Reg. at 50,224, 50,239.

10 Press Release, U.S. Dep't of the Treasury, Treasury Releases Proposed Regulations to Reform National Security Reviews for Certain Foreign Investments and Other Transactions in the United States (Sept. 7, 2019) (available at https://home.treasury.gov/news/press-releases/sm779).

Update on Regulatory Aspects of Clean Energy in Mexico

BY ANTONIO RIOJAS
Associate in the energy practice at
Cacheaux, Cavazos & Newton, LLP, Mexico City.

Good news regarding Mexico's electricity sector has been in short supply since late last year. Instead, the electricity industry has witnessed a series of controversial governmental decisions, which in certain cases clearly contradict the principles of Mexico's 2013-2014 electricity reform.[1] Such decisions included: exertion of unjustified political pressure against the former President of the Energy Regulatory Commission ("CRE" by its acronym in Spanish); the appointment of five new CRE Commissioners whose profiles and Senate confirmation hearings were criticized by both the general public and industry specialists; modifications to the strict legal unbundling of the Federal Electricity Commission ("CFE" by its acronym in Spanish); the cancellation of two proceedings to build transmission lines in Oaxaca and Baja California; and the suspension of auctions of financial transmission rights.

Most remarkable was the announcement by the National Center for Energy Control ("CENACE" by its acronym in Spanish), back in February 2019, of the cancellation of the fourth long-term auction. Not only did this paralyze a large number of clean energy generation projects in the country but it also suspended the most important mechanism that Mexico has for meeting clean energy goals and its resulting contribution to climate change mitigation.

However, at the end of September 2019, the Mexican government sent a different message when the head of the Department of Energy[2] ("SENER" by its acronym in Spanish) made several statements that caught the sector by surprise, this time in a positive way. The Secretary of Energy noted that a fourth long-term auction was likely to be held and that it would occur "as soon as possible" but would be subject to two conditions. To paraphrase, the conditions are that the future auction would: (i) be held as permitted by congestion in the National Transmission Grid; and (ii) be regional, unlike the previous auction, "in order to achieve territorial balance." Despite the conditions and the lack of a specific date for implementation, these statements were well received by the sector.

Unfortunately, the positive mood was short-lived as two new headlines came out a few days later. First, on October 7, 2019, SENER sent a draft amending the guidelines that establish the criteria for the issuance of clean energy certificates ("CELs" by its acronym in Spanish) and the requirements for their acquisition (the "Resolution") to the National Commission for Regulatory Improvement ("CONAMER" by its acronym in Spanish). The Resolution was published on October 28, 2019, in the official journal of the Federation and became effective the next day. The second headline centered on the appearance

of the CFE General Director[3] before the Mexican federal House of Representatives on October 10, 2019.

The stated objective of the Resolution is to convert grandfathered power plants into creditors of CELs. This means that the CFE's old clean power plants, most of which are hydroelectric, but also some geothermal and nuclear, will receive CELs from the CRE. This contradicts the objective of CELs, which is to incentivize the growth of new clean generation plants in addition to the capacity that existed prior to the electricity reform.

The Resolution, which was subject of at least 60 comments on the CONAMER website, presents several problems, among which are the following: (i) it favors the CFE, which is already the largest participant in the wholesale electricity market; (ii) it is a seemingly deceptive way to accomplish the clean energy goals that Mexico has set forth; (iii) it breaches the promise of the current administration not to modify the energy legal framework within its first three years; and (iv) it implies potential manipulation of the market owing to the oversupply of CELs and its possible depreciation, which as a practical matter could nullify the incentive for new clean energy projects.

On the other hand, the CFE General Director appeared before the House of Representatives and pointedly stated, among other things, that: (i) clean energy is too expensive because it requires backup from conventional power plants; (ii) CFE, as a state company, should generate more electricity and such can be accomplished mainly with the modernization of its hydroelectric plants; and (iii) neither medium nor long-term auctions are necessary for CFE to acquire electricity and associated products.

If one can conclude anything from the above, it is that the landscape for clean energy in Mexico has become more complicated. Many hope the current administration will take into account legitimate concerns from stakeholders and, upon greater reflection, reconsider the role of clean energy projects' development in promoting domestic investment and employment to address climate change responsibly.

> “The landscape for clean energy in Mexico has become more complicated.”

Antonio Riojas is senior associate in the energy practice at Cacheaux, Cavazos & Newton, LLP in Mexico City, where he focuses in regulatory matters for utility-scale renewable energy projects. Regarding his academic background, Antonio was awarded a Fulbright scholarship and studied a Master of Laws in Environmental Law and Policy at Stanford University, concentrating his degree plan on energy and natural resources. Contact: ariojas@ccn-law.com.mx. ■

Endnotes

1 The Constitutional amendment became effective December 21, 2013.
2 Norma Rocío Nahle García was appointed on December 1, 2018, and remains in office.
3 Manuel Bartlett Díaz was appointed on December 1, 2018, and remains in office.

The New Mexican Regulation to Prevent Psychosocial Risks in the Workplace

BY DR. CARLOS A. GABUARD, PH.D.
Founder of Gabuardi Abogadosi

On October 23, 2019, the Mexican Secretariat of Labor issued a new regulation to prevent psychosocial risks in the workplace ("NOM-035").[1] The purpose of NOM-035 is the early identification and assessment of potentially unsafe or dangerous conditions within or around the workplace. The regulation focuses in particular on conditions that may create anxiety disorders, including: sleep disorders; severe adaptation problems in the labor setting; negative interference with work and family life; or negative leadership. The regulation promotes positive organizational environments by encouraging the active participation of workers in this process. It requires that workers and employers take all necessary measures to prevent and mitigate psychosocial risks in the workplace. NOM-035 also targets harassment that may harm workers' integrity or health. However, the regulation's noble intentions are undermined by its "one-size-fits-all" approach and overbroad scope that make its effective implementation unrealistic.

This regulation sets forth provisions for (i) the identification and analysis of psychosocial risk factors for working places; (ii) the performance of medical examinations and psychological tests when signs of risk are found; (iii) record-keeping requirements, and (iv) the employers' obligation to address these issues. Part of this regulation goes into effect on October 23, 2020, while the remainder goes into effect on October 23, 2021.

Sections involving employers' obligations enter into effect on October 23, 2021, and are as follows: (i) to identify and analyze psychosocial risk factors for work places of various sizes; (ii) to perform medical examinations and psychological tests for workers that have been exposed to labor violence or to assess psychosocial risk factors if workers have symptoms or complaints of health concerns; (iii) to keep records on all matters referred to above and about the measures to control these risks; (iv) to keep records on the names of the workers that were exposed to psychosocial risks, labor violence, or severe traumatic occurrences; (v) to identify and analyse the potential negative implications of work schedules that exceed the limits set forth by the Federal Labor Statute; (vi) to identify and analyse the potential negative implications of imbalances between labor responsibilities and workers' personal and family life; (vii) to implement suitable programs to cope with existing psychosocial risks, labor violence, and negative leadership and labor environments, and (viii) to implement appropriate actions and programs to cope with these matters.

This regulation takes the form of a Mexican Official Standard ("Norma Oficial Mexicana"), and its original draft

was first introduced and submitted for public consultation before the Mexican Committee for Working and Health Standards in the Workplace on September 26, 2016.

Contents of NOM-035

NOM-035 is divided into three major sections: the first section contains the substantive content of the regulation, the second section delineates temporary rules for the regulation taking effect, and the third section includes five guidelines for its implementation. The regulation provides different rules of implementation depending on the number of workers in a given workplace (1 to 15, 16 to 51, or 50+ workers). It focuses on "severe traumatic events" that may be life-threatening or may trigger a post-traumatic disorder among persons who experience such an event.

This regulation requires employers to implement policies and measures to prevent psychosocial risks, labor violence, and to promote a favorable working environment; to identify and assess psychosocial risks factors, as well as to evaluate the organizational environment in this context; to take all necessary measures to prevent and control those risks; to promote a favorable working environment and to address negative practices that may favor work violence or pose a threat against a positive working environment; to identify workers that have been exposed to severe traumatic events and refer them for medical treatment; to implement medical and psychological tests whenever there are signs of potential labor violence or psychosocial risks; and to implement awareness campaigns on such policies and on the mechanisms to submit complaints on these matters. Employers must also keep records on their findings on these issues; on the control measures taken to cope with them; and on the names of the workers who have been tested for risks factors, including those found to have been exposed to psychosocial risks, labor violence, or other severe traumatic events.

> "My main concern about this regulation is that its implementation will be so complex and cumbersome that it will be either impossible to implement or it will be implemented in a completely arbitrary manner."

In turn, all workers shall (i) observe the measures and policies implemented by employers on these matters, including the identification and assessment of any potential threats; (ii) refrain from practices that may unsettle a positive working environment and from committing acts of labor violence; (iii) report acts of labor violence or potential threats to health and security in the workplace; (iv) participate in all awareness campaigns and to help assess their work environment; (v) report all acts of work violence and practices that hinder a positive work environment through the appropriate mechanisms; and (vi) submit themselves to medical tests and psychological assessments as required under NOM-035.

Finally, NOM-035 provides five non-mandatory reference guides on the following items: (i) identification of workers that were subject to severe traumatic events: (ii) identification and analysis of psychosocial risks for work places with up to 50 workers; (iii) identification and analysis of psychosocial risks for work places with more than 50 workers; (iv) policies to prevent psychosocial risks; and (v) questionnaires to get information about the workers.

Verification of compliance with the provisions of this regulation may be made through contracting an accredited verification unit or through the labor agencies of the Mexican Secretariat of Labor and Social Welfare.

Comments on NOM-035

My first general comment before addressing the specifics of NOM-035 is that under Mexican Law, all employees, whether blue-collar workers or office staff, are considered "workers" under the Federal Labor Law and NOM-035.

My main concern about this regulation is that its implementation will be so complex and cumbersome that it will be either impossible to implement or it will be implemented in a completely arbitrary manner. Indeed, in its current form, NOM-035 uses extremely broad language subject to multiple interpretations. It introduces concepts of highly questionable nature that may have negative effects on the human rights of workers. It is a "one-size-fits-all" regulation that aims too high in terms of good intentions. Further, the regulation targets such a broad spectrum of scenarios concerning the employer-employee relationship that it actually does not target any of them. NOM-035's overbroad scope includes work places that have only one employee as well as those that have thousands of workers. It targets activities ranging from industrial manufacturing to commercial retailing, and all kind of

services, including education, marketing, lawyering, accounting and more. It spans all types of psychosocial situations, forms of harassment, types of labor violence, all sorts of severe traumatic events, the effects and risk of post-traumatic disorders, awareness campaigns, and the list continues. Indeed, there is much truth to the old proverb: "He who wants too much doesn't catch anything."

As I mentioned at the beginning of this piece, NOM-035 takes the form of a Mexican Official Standard ("Norma Oficial Mexicana"). In legal terms, this distinction means that this regulation is subordinated both to the legislation enacted by the Mexican Congress and to the regulations issued by the Mexican President. It is highly questionable that the subject matter of NOM-035 should be a Mexican Official Standard rather than that a full-fledged regulation. However, Mexican Official Standards are not issued by the Mexican President, but by the Secretary heading the government area in which the Official Standard will be enforced, which for NOM-035 is the Secretariat of Labor and Social Welfare. Interestingly, this also means a greater degree of flexibility to potentially amend its content.

In my opinion, creating safer and more stable work environments for everybody is a noble cause and most likely few people would disagree about the desirability of this goal. However, implementing the legal and material measures to reach such a goal may not be as easy as aiming for it. Indeed, not only is it highly questionable that such a broad "one-size-fits-all" regulation may be realistically and successfully implemented, but these measures will also impose a significant cost and burden to Mexican companies.

Finally, I think this regulation responds to a global trend aiming to create safer and more stable working environments for everybody—employers and workers.

Conclusions

The "one-size-fits-all" solution provided by NOM-035 appears to be only the first step in which different Mexican employers should actively begin the process towards negotiating a standard suitable to their particular circumstances. However, one should acknowledge that a legal compliance process has already started and all industries doing business in Mexico should be prepared to deal with it. I have the impression that the agencies overseeing the implementation of this new regulation will not implement a hard enforcement policy, but rather will be open to initiating a dialogue towards compliance. However, new trends of litigation may be reasonably expected, and failure to comply with the existing standards may eventually be considered as negligence of both the employer and its principals. Additionally, we can also reasonably expect that in the face of having to provide expensive treatments for psychosocial matters developed in the workplace, the Mexican Agency for Public Health Services ("Instituto Mexicano del Seguro Social") may aggressively try to recover monies from employers who fail to comply with the new psychosocial requirements. Accordingly, I strongly recommend companies to consult with Mexican counsel on how business may be affected by these new measures.

●●●

Dr. Carlos A. Gabuardi, Ph.D. is a practicing lawyer in Monterrey, Mexico, and founder of Gabuardi Abogados (www.gabuardi.com, cgabuardi@gabuardi.com). He holds a License in Jurisprudence from the Universidad de Monterrey; a Master of Laws, with distinction, and a Doctorate of Laws (Ph.D.) from Tulane University. Dr. Gabuardi has published several articles in Law Reviews and Journals in Mexico and abroad. Dr. Gabuardi's practice focuses on assisting foreign investors doing business in Mexico. He is currently a Professor of Comparative Law and Distinguished Legal Researcher at Facultad Libre de Derecho de Monterrey, and an Adjunct Professor of Law at Universidad Iberoamericana Torreon. He frequently provides opinions, testimonies, and affidavits on Mexican law, international business law, international family law, and forum non conveniens before foreign courts. ■

Endnotes

1 Official Journal of the Federation of October 23, 2019.

The Pot Play: Should U.S. Investors Buying Into Foreign Cannabis Markets Be Concerned About U.S. Law Enforcement Risk?

BY CHRIS MCALISTER
Vinson & Elkins LLP, Dallas

The goal of this article is to provide a high-level view of the global cannabis industry and the applicable legal landscape, with a particular focus on investments in Canada made by businesses based in the United States and whether such businesses could be exposed to law enforcement risk in the U.S. given the federally prohibited status of cannabis. Given the rapidly changing and patchwork nature of such legal landscape, this article does not speak to whether any such investment was, is or will become advisable, but rather attempts to identify U.S. federal laws and other government pronouncements likely to affect the investment decisions of U.S.-based companies, and recent real-world examples of such investments. In the interest of not burying the lead, while such investors may want to doublecheck the depth of their pockets prior to investing due to the financial risks involved, there does not appear to be much risk from U.S. law enforcement for U.S.-based businesses that want to invest in legal foreign cannabis markets.

This article is structured as follows: (1) a brief cannabis primer, (2) a recent legal history of the nascent global cannabis industry, (3) an outline of the U.S. federal laws and other government pronouncements that may affect a U.S.-based company's decision to invest in the global cannabis industry and (4) a sketch of two of the most prominent recent investments by U.S.-based companies in Canadian cannabis.

Cannabis Primer

As a threshold matter, it is necessary to mark a bright-line distinction among two primary types of the *Cannabis* sativa plant—hemp and marijuana—as most legal regimes currently depend on such classifications. Any reference herein to "cannabis" encompasses both of these distinct types.[1]

The two most prevalent active compounds of both hemp and marijuana are *Tetrahydrocannabinol* ("THC"), which is the compound that produces the psychoactive "high" most frequently sought by recreational consumers, and *Cannabidiol* ("CBD"), which produces the physiological effects of cannabis without the psychological high tied to higher concentrations of THC. The relative concentrations of THC and CBD in hemp and marijuana is currently the most

common method used to dictate legality in a given jurisdiction.[2]

For example, federal statutes in both the U.S. and Canada require that hemp (which has been legalized in both countries) contain equal to or less than 0.3% THC, which is an insufficient concentration to produce any physiological or psychological effects.[3] However, CBD can be extracted from legal hemp in commercially viable amounts, evidenced by the recent proliferation of CBD-based consumer products available in the U.S., Canada and other countries.[4]

In contrast with hemp, both medical and recreational varieties of marijuana have much higher concentrations of THC, with medical tending to lean more heavily towards CBD and recreational favoring a more THC-dominant variety.[5] In the U.S., despite an increasing number of states legalizing both medical and recreational use of marijuana, it remains illegal at the U.S. federal level. And as every good law student knows, the Supremacy Clause of the U.S. Constitution sets forth that, except in very limited circumstances inapplicable here, federal law preempts state law.[6]

Recent Legal History of Global Cannabis Industry

With a basic understanding of the applicable cannabis classifications in hand, we now turn to an overview of global legal treatment of cannabis. Given the variance among countries of the extent to which cannabis has been decriminalized, medically legalized or recreationally legalized, it will aid our discussion to expand upon these categories as they pertain to international investment.

First, and least helpful to fostering investment, is simple decriminalization of the plant. Decriminalization is typically the first step a country takes on the path toward medical or recreational legalization, and has been effected in myriad countries. Second is legalization for use in various medical capacities, usually requiring a doctor's prescription, with such legalization serving as the foundation for global cannabis investment over the past two decades as the industry has progressed through its infant stages. Third is the legalization of cannabis use for recreational purposes, which is the broadest form of legalization and most helpful to international investment. As decriminalization alone is not conducive to investment, we will focus on medical and recreational legalization. And size does matter—the global market for legal marijuana, both medical and recreational, is expected to surpass $50 billion by the end of 2024.[7]

As of the writing of this article, Uruguay (2013) and Canada (2018) are the only countries to have fully legalized and regulated the use and sale of marijuana for both medical and recreational purposes.[8] In contrast, a host of countries, representing every continent aside from Antarctica, have legalized medical use in one form or another (e.g. Canada in 2001, Italy in 2013, Colombia in 2015, Australia in 2016, Zimbabwe in 2018 and South Korea in 2019). Given how widespread the march toward legalization has been across the world, there will soon be no shortage of international markets in which U.S. businesses can consider investing. But what about the law enforcement risks to which a U.S.-based business might be exposed by investing in an industry that is fully legal in its own jurisdiction, but federally illegal in the U.S.? We turn next to U.S. federal laws and related government pronouncements that may present such risks.

U.S. Federal Law & Enforcement Risks Posed to U.S. Businesses

The U.S. federal laws that could be construed as exposing U.S. businesses investing in foreign cannabis to law enforcement risk include (1) the Controlled Substances Act (the "CSA"), (2) the Controlled Substances Import and Export Act (the "CSIE"), (3) the Money Laundering Control Act (the "MLCA"), (4) the unlicensed money transmitter statute, (5) the Bank Secrecy Act (the "BSA"), and (6) the Racketeer Influenced and Corrupt Organizations Act ("RICO").[9]

As of the writing of this article and to the knowledge of the author, the U.S. has never brought charges against a U.S. investor as a result of its investment in the global cannabis industry, and as a result there is no directly applicable case law to serve as a guide. Thus, to best determine the applicable risk, we must review the federal statutes set forth above with our U.S.-based cannabis investor in mind.

Despite domestic and global momentum for medical and recreational legalization, marijuana remains expressly banned in the U.S. as a Schedule I drug under the CSA.[10] Significantly, however, the U.S. federal ban on hemp was recently lifted pursuant to the 2018 farm bill, which, among other things, legalized the production of hemp as an agricultural commodity and removed it from the CSA.[11] As a result, the analysis provided herein applies only to marijuana, and not to hemp.

Law enforcement risk under U.S. federal law stems from the designation of marijuana as a Schedule I drug under the CSA. Schedule I drugs, which, in addition to marijuana, include drugs such as heroin, are those deemed to have a high potential for abuse, no currently accepted medical use and lack of accepted safety parameters for use under medical supervision.[12] Were marijuana to be removed from the CSA as was done with hemp, further analysis would be rendered unnecessary as it would remove the basis upon which enforcement of current law would stand. Since that has not yet come to pass, let us look at applicable U.S. federal laws currently on the books and the likelihood of their application to the present investment scenario.

As the Supreme Court of the United States stated in RJR Nabisco Inc. v. European Cmty, "clearly expressed congressional intent to the contrary, federal laws will be construed to have only domestic application."[13] Therefore, statutes that are silent with respect to their application in foreign jurisdictions will be interpreted to apply only to activities occurring within the U.S. The text of the CSA lacks an express intent to apply the law outside of the U.S., indicating that such statute is not intended to apply to overseas conduct and is not a concern for a U.S. business considering investing in foreign marijuana. However, the U.S. does have federal laws intended to be applied outside the U.S., and we have already mentioned one such law that may apply—the Controlled Substances Import and Export Act (the "CSIE").

The CSIE prohibits the possession of controlled substances overseas with the intent to import them into the U.S.[14] Notably, intent to import the applicable controlled substance into the U.S. is a necessary element of such statute. As a result, the CSIE would not apply to Canadian or other foreign marijuana operations that have no intent to export marijuana to the U.S., but rather intend only to sell within its own domestic regulated market or other legal international markets. More concerning for our U.S.-based cannabis investor is the MLCA, which rests only on movement of funds and has been interpreted as having broad extraterritorial reach.

The MLCA criminalizes the knowing engagement or attempted engagement in a monetary transaction involving property of a value in excess of $10,000 when such property is derived from "specified unlawful activity."[15] In contrast with the CSA, this law applies to a U.S. person or business formed in the U.S. even if the prohibited conduct takes place outside the U.S. Further, the definition of "specified unlawful activity" expressly includes violations of the CSA. But, as the CSA only applies to domestic activity, U.S.-based investment in an otherwise legal foreign marijuana business does not run afoul of the MLCA. For similar reasons, prosecutorial potential under the unlicensed money transmitter statute, the BSA and RICO fail to cause concern for a U.S. business investing in a legal foreign marijuana market, as there are no underlying violations of the CSA.[16]

> "It appears highly unlikely that U.S. authorities would have any colorable basis upon which to prosecute U.S.-based investors for investing in Canadian or other foreign marijuana markets."

Thus, while U.S. federal laws pose significant law enforcement risk to U.S.-based marijuana businesses, it appears highly unlikely that U.S. authorities would have any colorable basis upon which to prosecute U.S.-based investors for investing in Canadian or other foreign marijuana markets.[17] Further, guidance memoranda issued by the Department of Justice and FinCEN, such as the Cole Memos and more recent Sessions Memo, have been circulated in an attempt to bring enforcement clarity to U.S. state-based marijuana programs and the conflict with the CSA caused by their ongoing operations, and do not apply to a U.S. investor considering investment in legal foreign marijuana.

Constellation and Altria Investments

Not only is the risk of law enforcement low in theory, there have also been practical demonstrations of U.S.-based investor confidence in the legality of investments in legal foreign marijuana. The two most prominent examples of this are the $4 billion investment made by Constellation Brands, Inc. ("Constellation") in Canopy Growth Corporation ("Canopy") and the $1.8 billion investment made by Altria Group, Inc. ("Altria") in Cronos Corp. ("Cronos").

Constellation is a large-cap NYSE-listed corporation known for popular beer brands such as Corona and Pacifico, and Canopy is a market leading vertically integrated Canadian cannabis company. The investment by Constellation in Canopy closed on November 1, 2018 and was structured as a share subscription agreement pursuant to which Constellation acquired approximately 38% of the outstanding common shares of Canopy, with warrants that would enable Constellation to increase its ownership stake to 55%. Commenting on the transaction, Constellation CEO Rob Sands remarked that "the global cannabis market presents a significant growth opportunity and Canopy Growth is well-positioned to establish a strong leadership position in this fast-evolving category."[18]

Altria is also a large-cap NYSE-listed corporation, and is one the world's leading manufacturers of tobacco, cigarettes and related products. And like Canopy, Cronos is a leading vertically integrated Canadian cannabis company. The investment by Altria in Cronos closed on March 7, 2019 and was structured as a share subscription agreement pursuant to which Altria acquired approximately 45% of the outstanding common shares of

Cronos, with warrants that would enable Altria to increase its ownership stake to 55%. Commenting on the transaction, Altria Chairman and CEO Howard Willard noted that "Cronos Group is our exclusive partner in the emerging global cannabis category and represents an exciting growth opportunity for Altria."[19]

Conclusion

As noted at the outset of this article and supported in the subsequent paragraphs, U.S.-based investors looking to buy into Canadian or other foreign legal marijuana markets would be best served by focusing risk analysis on the financial advisability of any such investment, rather than any perceived law enforcement risk. Although U.S. marijuana businesses are exposed to significant law enforcement risk under a variety of U.S. federal laws stemming from the prohibition of marijuana under the CSA, since the CSA does not apply to conduct outside of the U.S., the same risk does not apply to U.S.-based businesses investing in legal foreign marijuana markets. With such law enforcement risk addressed and dismissed as inapplicable, only time will tell whether big cannabis bets such as those made by Constellation and Altria end up in the green.

●●●

Chris McAlister (cmcalister@velaw.com) is an associate in the finance group of Vinson & Elkins and his practice focuses on a diverse group of commercial lenders, corporate borrowers and private equity firms in a wide variety of commercial financing transactions. ■

Endnotes

1 Nepveux, M. 2018 Farm Bill Provides A Path Forward for Industrial Hemp. February 28, 2019. https://www.fb.org/market-intel/2018-farm-bill-provides-a-path-forward-for-industrial-hemp.

2 Jensen, B. et al. Curr Pain Headache Report: Medical Marijuana and Chronic Pain, a Review of Basic Science and Clinical Evidence. October 2015; 19 (10): 50.

3 See the Agriculture Improvement Act of 2018, which amended Section 297A of the Agricultural Marketing Act of 1946 to permit legal industrial hemp (codified at 7 U.S.C. § 1621 et seq.).

4 FDA Regulation of Cannabis and Cannabis-Derived Products, Including Cannabidiol, https://www.fda.gov/news-events/public-health-focus/fda-regulation-cannabis-and-cannabis-derived-products-including-cannabidiol-cbd; Canadian CBD Laws – Everything You Need to Know, https://www.greencanadacbd.ca/canadian-cbd-laws/.

5 Parker, K. et al. Financial Markets, Inst. & Inst.: Risk Management within the cannabis industry: Building a framework for the cannabis industry. 2019; 28: 3, 6.

6 Article VI, Clause 2 of the Constitution of the United States.

7 Arcview Market Research and BDS Analytics, The State of Legal Cannabis Markets (7th Ed.) (2019).

8 Parker, 2.

9 (1) Controlled Substances Act (21 U.S.C. §§ 801-12); (2) Controlled Substances Import and Export Act (21 U.S.C. §§ 951-59); (3) Money Laundering Control Act (18 U.S.C. §§ 1956-7); (4) the unlicensed money transmitter statute (18 U.S.C. § 1960); (5) Bank Secrecy Act (31 U.S.C. § 5311 et seq.); (6) Racketeer Influenced and Corrupt Organizations Act (18 U.S.C. §§ 1961-8).

10 Controlled Substances Act, 21 U.S.C. § 812 (2012).

11 Supra fn 4.

12 Parker, 19.

13 RJR Nabisco Inc. v. European Cmty, 136 S. Ct. 2090, 2091 (2016).

14 Controlled Substances Import and Export Act, 21 U.S.C. § 959 (2012).

15 Money Laundering Control Act, 18 U.S.C. § 1957 (2012).

16 Unlicensed money transmitter statute, 18 U.S.C. § 1960; BSA, 31 U.S.C. 5318(g); RICO, 18 U.S.C. 1961-2.

17 McVay, R. Investing in Marijuana Businesses Abroad. November 2, 2017. https://www.cannalawblog.com/investing-in-marijuana-businesses-abroad/.

18 Canopy Growth Corporation (2018). November 1, 2018 Material Change Report.

19 Altria Group, Inc. (2019). March 8, 2019 Press Release.

THANK YOU
VINSON & ELKINS

The ILS wishes to thank V&E for its efforts by its lawyers and staff to publish the International Newsletter.

Vinson&Elkins

With nearly 700 lawyers in 13 offices around the world, V&E offers experienced legal counsel and top-tier service, assisting sophisticated corporate clients in transactions, projets, compliance, and disputes across various industries in established and emerging markets worldwide.

Vinson & Elkins LLP Attorneys at Law
Austin Beijing Dallas Dubai Hong Kong Houston London
New York Richmond Riyadh San Francisco Tokyo Washington

velaw.com

CALENDAR – UPCOMING EVENTS

2020

February 27

The Seventh Annual International Law Seminar & Networking Lunch
Dallas

April 23-24

32nd Annual Institute
Dallas

May 6 – 8

ILS Annual Trip
Toronto

June 25-26

State Bar Annual Meeting
Dallas

INTERNATIONAL LAW SECTION
THE STATE BAR OF TEXAS

The next issue of ILS Quarterly will be published Spring 2020.

To contribute, please email submission inquiries to:

Tom Wilson
Editor in Chief
twilson@velaw.com

Gabriela N. Smith
Chair
gsmith@gnslawplc.com

The editors and counsel of the International Law Section have sole authority to determine whether any submission is appropriate or meets the standards to be included in this publication.