Testimony of Dennis Arriola, Executive Vice President, Sempra Energy
Before the Ways and Means Subcommittee on Trade
Hearing on "Modernization of the North American Free Trade Agreement (NAFTA)"
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Chairman Reichert, Ranking Member Pascrell, thank you for this opportunity to testify about the upcoming renegotiation of the North American Free Trade Agreement. My name is Dennis Arriola, and I am Executive Vice President, Corporate Strategy and External Affairs, for Sempra Energy.

Sempra Energy, based in San Diego, is a Fortune 500 energy services holding company with 2016 revenues of over $10 billion. The Sempra Energy companies' more than 16,000 employees serve approximately 32 million consumers worldwide. Sempra Energy is organized into two operating groups: Sempra Utilities and Sempra Infrastructure.

Sempra Utilities includes Southern California Gas Company (SoCalGas), San Diego Gas & Electric (SDG&E) and two South American electric utilities. SoCalGas has the largest customer base of any U.S. natural gas distribution utility, providing safe, reliable and affordable service to about 22 million consumers. SDG&E is an electric and gas utility that provides safe and reliable energy to more than 3.5 million consumers in San Diego and southern Orange Counties.

Sempra Infrastructure includes Sempra Mexico, Sempra LNG & Midstream and Sempra Renewables. Sempra LNG & Midstream develops and builds liquefied natural gas facilities, midstream natural gas infrastructure and natural gas storage. Sempra Renewables is a leading U.S. developer and operator of renewable energy with joint or solo ventures holding nearly 2,400 megawatts of solar and wind capacity nationwide.

Sempra Mexico includes IEnova, one of the largest private energy companies in Mexico. IEnova's footprint in Mexico spans several lines of business: natural gas transportation, distribution, and storage; electricity generation (natural gas, wind and solar); and liquids storage and transportation. IEnova is the largest private natural gas pipeline company in Mexico, facilitating most of the U.S. gas deliveries into Mexico. As of 2016, we have almost 900 employees working there and we have invested more than $7 billion dollars.

Our investments in Mexico have made excellent business sense for Sempra Energy. Our expansion of investment in energy infrastructure in Mexico is one of the key contributing factors to an approximate 45 percent increase in Sempra Energy's market capitalization over the past four years – from approximately $19 billion to $28 billion. This has translated to hundreds of new jobs on both sides of the border---good paying jobs for engineers, operators, accountants, lawyers and others.

Investing in Mexico has also been a natural geographic extension of our business. Our San Diego operations share a border with Mexico. We are tied together economically, environmentally and culturally. We built the region's first cross-border energy ties in 1983. We installed air-quality monitoring equipment to establish a clean air baseline for our region. We enabled the conversion of Mexican power plants near our border to run on cleaner-burning natural gas instead of heavy fuel oils. Also, in 1995, we earned the first license awarded to a private company to build and operate local natural gas distribution utilities. Sempra's dynamic growth has been fueled, in part, by NAFTA, and we are glad that the Subcommittee has included a focus on cross-border energy in this hearing.

NAFTA and Energy

NAFTA has been a big win for the U.S. energy sector. It has helped to create a robust and integrated North American energy market that supports U.S. jobs and strengthens our energy security. U.S. trade with Canada and Mexico in energy commodities, including electricity, liquid fuels, and natural gas, exceeds $140 billion annually.

As Sempra operates in the U.S. and Mexico, I will focus my comments on the importance of NAFTA to energy trade between these two partners. Last year, the U.S. enjoyed a trade surplus in energy commodities with Mexico of more than $11 billion, with more than $20 billion in U.S. exports to Mexico and less than $9 billion in U.S. imports from Mexico. Of the $20 billion in U.S. exports, natural gas accounted for $3.7 billion, and was accounting for nearly 60 percent of all U.S. natural gas exports.

As impressive as these numbers are, however, we are just beginning to tap the potential of U.S.-Mexico energy trade. Mexico's natural gas imports, for example, are expected to double in just the next five years. Mexico's per capita electricity consumption, which is only one-third the OECD average, is projected to double during the next 25 years. With respect to renewables, Mexico has a target of 35 percent of electricity generation from clean energy by 2024.

Sempra's investments in Mexico through IEnova support many U.S. jobs, both directly and more broadly through U.S. shale energy development. These investments have supported domestic electric grid reliability in both California and Texas. And our investments help address greenhouse gas and local pollution challenges in Mexico by using clean natural gas for electric generation, and introducing more solar and wind resources. A growing energy trade partnership is a win-win outcome for both the U.S. and Mexico.

Sempra and other U.S. energy companies are well positioned to meet Mexico's rising demand for energy. As the two countries prepare to re-open NAFTA, we urge Congress and the Administration to follow this guiding principle: maintain the existing benefits of NAFTA while improving it in ways that expand trade and investment.

Maintain Existing NAFTA Benefits

For Sempra and other energy companies, four critical benefits must be maintained:

- zero tariffs on all energy goods, including electricity and natural gas;

- open markets and non-discriminatory treatment for energy services and investment, including power generation and transmission;
- strong investment protections for cross-border projects, enforceable by Investor-State Dispute Settlement (ISDS); and
- a provision that locks in market opening reforms, including in the energy sector, that Mexico has enacted since NAFTA was signed, known as "the ratchet."

Let me take a moment to focus on the last two points, beginning with investment protection. For our U.S. LNG business, Sempra serves foreign markets by investing in the construction of U.S. pipelines and U.S. liquefaction facilities and exporting U.S. natural gas. But for our international electricity and natural gas businesses, like the ones we have in Mexico, we can serve foreign markets only if we are present in those markets. We must go where the resources and markets are located, build the generation, transmission, and distribution facilities, and supply electricity and natural gas to local customers. This is not about transferring jobs from the U.S. to Mexico, this is about growing investment that benefits the economies of both countries.

Such projects require Sempra to invest hundreds of millions of dollars, often in countries where the legal regimes are not as developed as the U.S. The investment protections in NAFTA and other U.S. free trade agreements enable us to mitigate this risk, expand our business and compete for global customers. They provide Sempra and other U.S. investors with reciprocal rights in foreign markets that foreign investors enjoy in the United States under federal law: non-discriminatory treatment, compensation in the event of expropriation, and due process.

ISDS provides a neutral forum and an impartial arbitral tribunal to hear claims for breach of the agreement. Even if a company never files a claim, the existence of these protections, and the availability of ISDS, is an essential insurance policy. That is why we strongly urge that they be maintained.

I also mentioned the so-called ratchet mechanism. This is a technical provision, but very important. It states that if a party opens its market after NAFTA enters into force, then the party's NAFTA commitment "ratchets up" to this new level of market openness. If the party subsequently restricts such access, it would be in breach of its NAFTA commitments.

When NAFTA was negotiated in the early 1990s, much of the Mexican energy sector was effectively closed to U.S. and other foreign companies. In 2013, however, Mexico amended its constitution and enacted legislation to reform the energy sector and welcome increased foreign investment. The ratchet mechanism captures these reforms and affords protection against them being reversed.

Modernize NAFTA in Ways that Expand Trade and Investment

In addition to maintaining existing benefits, the NAFTA renegotiation affords an opportunity to strengthen and improve the agreement. In this regard, we offer four recommendations.

First, while the ratchet mechanism captures Mexico's reforms, the text of the agreement should be amended to reflect the current level of market openness. In particular, Mexico's broad exception for energy should be removed and replaced with a short and specific list of exceptions for those areas of energy law that remain inconsistent with the NAFTA obligations. As compared to the ratchet alone, a specific list of exceptions defines more precisely the scope of Mexico's obligations and provides a roadmap for further liberalization.

Second, NAFTA should be amended to cover so-called investment agreements, consistent with other U.S. free-trade agreements. An investment agreement is a type of contract between investors and the host government, such as a contract to develop natural resources or supply services to the public, such as power generation or distribution. The investor may bring a claim in ISDS for simple breach of contract, even if the action would not constitute a breach of standards of treatment in the free-trade agreement itself.

Third, the Administration could strengthen NAFTA by adding a so-called "tail" of investment protection if the agreement were ever terminated. Most free-trade agreements include such a provision that continues to apply the terms of the chapter for a period of time (usually ten years) after the agreement is terminated. This assures investors that the legal protections and enforcement mechanisms that might have been an important factor in their deciding whether to invest will not be suddenly withdrawn.

Fourth, the Administration could strengthen NAFTA by increasing regulatory coordination in the energy sector, particularly with respect to the cross-border infrastructure process. While each of the NAFTA parties may reserve the right to approve such projects, they could agree on guidelines for decision-making criteria, consultation procedures, and standard timelines. From our own experience with both cross-border transmission and gas pipeline infrastructure, we believe more North American energy integration from pipelines and transmission lines is mutually beneficial to all three countries.

Conclusion

Mr. Chairman, NAFTA has been an enormous benefit to the U.S. energy industry. If negotiators can preserve these benefits, while finding consensus to modernize and improve the agreement, North America will become an even more integrated and powerful energy market in the years to come. And this will benefit U.S. workers, our economy and the environment.

Thank you for this opportunity to testify, and I look forward to your questions.