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Mexico’s Energy Industry

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Updated Bidding Guidelines and Contract Terms for Ronda Uno, Second Tender

On August 4, 2015, the Comisión Nacional de Hidrocarburos (the **CNH**) released revised versions of the Bidding Guidelines (the **Guidelines**) and the Model Production Sharing Contract (the **PSC**) for the Second Tender published on February 27, 2015 (the **Second Tender**). The Second Tender contains five (5) mature contract areas located in shallow waters off the Gulf of Mexico coastlines of Veracruz, Tabasco and Campeche.

This summary presents some of the most relevant changes in the Second Tender Bidding Guidelines and PSC which directly address key lessons from the First Tender, significantly increasing the competitiveness and value of the contract areas.

Timeline

The CNH adjusted the Second Tender Calendar to provide additional time and flexibility for interested parties to analyze the changes presented herein, to adjust their risk profiles and to negotiate strategic alliances under the new participation format rules. The revised timeline is presented below:

Round 1.2 Bidding Process Timeline

- **7/04**: CNH published updated Bidding Guidelines and Model PSC
- **7/10**: Last day participating parties can submit documentation supporting Prequalification requirements
- **8/14**: Last day for CNH to review prequalification supporting documentation
- **8/20**: Last to submit questions regarding Bids, Model PSC and Adjudication Process; CNH publishes **Final** list of Prequalified Parties
- **8/24**: Last day for CNH to answer questions regarding Bids, Model PSC and Adjudication Process
- **8/25**: CNH publishes **Final** Bidding Guidelines and Model PSC
- **9/11**: Last day to request authorization to include new non-prequalified Financing Parties to Consortium
- **9/18**: Last day to request authorization to change participation format, Consortium structure and interests
- **9/25**: Last day for CNH to grant authorizations regarding non-prequalified Financing Parties and changes to Consortium structure and interests
- **9/29**: Last day to access Data Room
- **9/30**: Bid envelopes are presented, opened and Tender winners selected
- **10/02**: CNH Resolution announcing Bid Winners is entered for publication in the National Gazette
- **11/06**: Last day to execute the Exploration PSC

Summary of Key Changes in the Final Guidelines and Model PSC

1. Corporate Guaranty: The definition of Corporate Guaranty and its application in Article 16.2 of the PSC have been revised, presumably to address some of the energy industry’s concerns during the First Tender. The new definition specifically establishes that the Corporate Guaranty will only be exercised as a last resort to ensure a Contractor's compliance with its obligations and only to cover the remaining balance after executing the Performance Guaranty and receiving insurance proceeds (if applicable). Article 16.2 includes very important changes in the Guarantor's obligations and financial requirements. For example, each Participating Company may present a Corporate Guaranty either (i) backed by its ultimate parent company as guarantor or (ii) backed by another company within the corporate umbrella which must demonstrate a minimum net worth equal to 18 times the sum of the values of the Minimum Work Program and the Increase to the Minimum Work Program. Particularly, the Operator's guarantor must demonstrate at least 50 percent of such minimum net worth. The net worth levels must be maintained above the minimum requirements on an annual average basis. If any given guarantor is unable to comply with these requirements, the Participating Company must notify the CNH within five days and provide a new Corporate Guaranty.

2. Administrative Rescission: One of the most important additions in this PSC version is the definition of the Mexican legal term "Culpa o Dolo." Article 22.1(i) establishes that "Culpa" is any act or omission that violates a rule, law or duty necessary to comply with Industry Best Practices caused by Contractor's negligence. "Dolo" is any act or omission by a Contractor or Participating Company with intent to directly accomplish a given result.

3. Participation Format: Significant changes have been implemented to Article 12.4 of the Guidelines, including (i) an Operator's right to act simultaneously as an Individual Bidder and as a member of a Consortium Bidder (limited to present only one (1) bid per contract area regardless of its participation format); (ii) if a Consortium Bidder loses its Operator, it may incorporate a new Operator or an Individual Bidder to act as an Operator. Overall, the following participation formats and modification schemes for the Second Tender provide substantially greater flexibility to interested companies to utilize a variety of different structures to maximize their expected return based on each contract area's risk profile, geological characteristics and investment requirements.

- Individual Bidder:
    - May join a Consortium Bidder as a Financial Partner (must renounce to its Individual Bidder status)
    - May join a Consortium Bidder as an Operator
    - May join Financial Partners and participate as Consortium Bidder
    - Must request CNH's authorization to modify its participation format
- Consortium Bidder:
    - May incorporate Individual Bidder as Financial Partner
    - May substitute Operator for Individual Bidder or other Operator
    - May have more than 1 Operator; if properly prequalified, different members may act as Operator in different contract areas

    - Designated Operator must hold at least 33% Consortium Interests
    - Any given Financial Partner may only own up to 66% Consortium Interests
    - Must request CNH’s authorization to modify its participation format
- Operator:
    - May simultaneously participate as an Individual Bidder and as a member in a Consortium Bidder
    - May only present 1 offer per contract area regardless of participation format
    - If “designated Operator”, must hold at least 33% Consortium Interests
    - Must request CNH’s authorization to modify its participation format

4. Production Sharing Adjustment Mechanism: The variables used to establish the Operating Profitability range in the Production Sharing Adjustment Mechanism in Annex 3, Article 8.3(b) have been revised from 20 percent to 25 percent and from 35 percent to 40 percent respectively. By shifting the Operating Profitability range, these modifications ultimately transfer a higher benefit to the Contractor.

5. Insurance Policies: Article 19.2 of the PSC now requires a Contractor to demonstrate by the time perforation activities commence that (i) general liability and well control insurance coverage have been obtained for up to USD$1 billion, and (ii) the Contractor has joined a General Mutual Insurance Fund that will provide well control services in the Gulf of Mexico.

6. Eligible Companies: Changes to Article 4.1(d) of the Guidelines provide useful clarifications on which companies are eligible to participate in the Second Tender. The new provision creates an exception for investment funds and financial backers which may participate or have noncontrolling interests in more than one Bidder, subject to all other rules regarding collusion, corporate control and confidentiality. This is a very market-oriented change that should specifically provide private equity funds, hedge funds and other investing groups much needed flexibility to invest in Mexico.

7. Performance Guaranty: Revised Article 16.1 of the PSC provides a Contractor the right to request annual proportional adjustments to the Performance Guaranty based on its progress and compliance with the minimum Work Program. This scheme will allow the Contractor financial flexibility as the contract advances because required reserve levels will decrease, effectively freeing cash and reducing the Contract’s opportunity cost. Annex 6, Section 7 establishes a new formula to calculate the amount of the Performance Guaranty in which the Work Units have been reduced by 50 percent.

8. Bid Guaranty: The definition of Bid Guaranty (*Garantia de Seriedad*) in the Guidelines was revised to cover all offers presented by a Bidder. Previously, each offer required its own Stand-by Letter of Credit for USD$2.5 million. Now, the same USD$2.5 million Stand-by Letter of Credit will work as Bid Guaranty for all offers presented. This modification effectively reduces the financial costs and commitment for Bidders as well as the opportunity cost involved in selecting between contract areas.

9. Arbitration: Revised Article 25.5 of the PSC establishes that if either party under the PSC rejected the Conciliation invitation or no agreement was reached during the Conciliation process, the General Secretary of the Permanent Court of Arbitration in the Hague will be the nominating authority during the Arbitration proceedings.

10. Evaluation Plan Delays: Article 4.4 of the PSC establishes that if Contractor fails to present the Evaluation Plan or the First Work Program in due time without just cause, it will be subject to a per diem fine calculated as follows:

$$\text{Penalty} = DR*[PMT/730]$$

Where: DR = Delay Days and PMT = Estimated Minimum Work Program Cost

Furthermore, this change has allowed the removal of Evaluation Plan Delay as a cause for Contract Rescission under Article 22.4 of the PSC.

11. Financial Obligation: Article 13.1(u) of the PSC now requires Contractors to maintain the same minimum net worth accredited during the Prequalification Process on an annual average basis.

12. **New Exploration**: Article 5.5 of the PSC provides a Contractor the right to explore new plays or fields within the contract area, subject to CNH’s approval.

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