

Energy Alert

December 23, 2015

Mexico's Energy Industry

Round One, Fourth Tender – Deep Water Blocks

At last, the much anticipated deep-water bidding round has been announced in Mexico. Following the precedent set in the recently completed auctions for Round 1.3, Mexico has used a form of license contract as opposed to a production sharing contract model for these key areas. On December 17, 2015, the Comisión Nacional de Hidrocarburos (CNH) published (i) the Call for Bidders No. CNH-R01-C04/2015 in the Federal Gazette (Diario Oficial de la Nación or DOF) and (ii) the corresponding Bidding Guidelines and the model form license contract for 10 Contract Areas located in the Perdido Belt and the Cuenca Salina, both deep-water regions of the Gulf of Mexico.

In this client alert, we will provide a brief summary of the most relevant characteristics of the Fourth Tender Bidding Guidelines and License. Complete copies of the guidelines and model form license can be found at ronda1.gob.mx.

Timeline

Round 1.4 Bidding Process Timeline

- 12/17: CNH publishes Tender 1.4 (Bidding Guidelines and License Contract) and Bidding Process begins
- 1/06: First day to request access and pay Data Room Fee, review Data Room information, pay Registration Fee, and submit questions
- 3/25: Last day to submit questions regarding Data Room access/information
- 4/01: Last day for CNH to answer questions regarding Data Room access/information
- 5/13: Last day for Interested Parties to pay Registration Fee and request Prequalification appointment
- 5/27: Last day to submit questions regarding Prequalification Process and Interested Parties
- 6/03: Last day for CNH to answer questions regarding Prequalification Process and Interested Parties
- 6/14: First day Interested Parties can submit documentation supporting Prequalification application
- 7/01: Last day Interested Parties can submit documentation supporting Prequalification application
- 7/04: First day for CNH to review documentation supporting Prequalification application
- 8/22: Last day for CNH to review documentation supporting Prequalification application
- 8/24: CNH publishes **Final** list of Prequalified Parties
- 9/29: Last day to submit Participation Formats, Consortium structures and interests
- 10/06: Last day for CNH to authorize Participation Formats, Consortium structures and interests
- 10/14: Last day to request changes to Participation Formats, Consortium structures and interests
- 10/21: Last day for CNH to authorize changes to Participation Formats, Consortium structures and interests, and to submit questions regarding Bids, License Contract and Adjudication Process
- 10/26: Last day for CNH to answer questions regarding Bids, License Contract and Adjudication Process
- TBD: CNH publishes **Final** Bidding Guidelines and License Contract (based on Bid Ceremony date)
- TBD: Last day to access Data Room (one day before Bid Ceremony date)
- TBD: Bid envelopes are presented, opened and Tender winners selected (Bid due date will be announced during 3rd quarter 2016)

Summary of Bidding Guidelines

1. **Fee for Access to the Data Room:** \$38,500,000 MXP – This fee is only required for parties that will prequalify as Operators. Non-Operators interested in reviewing the information contained in the Data Room may do so through an Operator or they may elect to pay the Data Room Fee.
2. **Registration Fee:** \$280,000 MXP – All parties interested in participating, whether as Operators or Financial Partners, are required to pay the Registration Fee.
3. **Experience Requirements for Operator:** Potential bidders must have (i) participated in at least one deep water (>1,000 meters) exploration/extraction project between 2011-2015, (ii) made capital investments in deep water exploration/extraction projects for at least US\$2 billion, and (iii) demonstrated experience in industrial and environmental safety programs for deep water exploration/extraction projects.
4. **Financial Prequalification Requirements for Operator:** Potential bidders must have (i) net worth of at least US\$2 billion, or (ii) US\$10 billion in total assets and an investment grade rating by Fitch, S&P or Moody's.
5. **Financial Prequalification Requirements for Non-Operator:** Non-Operator bidders are only required to have a net worth of at least US\$250 million.
6. **Participation Formats:** Prequalified bidders may only present one bid per Contract Area under the following rules:
 - Licitante Agrupado ("Consortium")
 - One or more Prequalified Operators
 - One or more Prequalified Non-Operators
 - Consortium parties must name one Operator for each particular Contract Area (as applicable)
 - Non-Operators may not have a higher economic interest than the Designated Operator
 - At least one Consortium member must have paid the Data Room Fee.
 - Individual Bidder
 - One Prequalified Operator
 - All individual bidders must have paid the Data Room Fee.
7. **Bid Guaranty and Cash Offer:** Each Bid must be accompanied by a Stand-By Letter of Credit for US\$3 million that must remain valid for 100 days from the date of the Bid Ceremony. In addition, each Bid must include a "Tie-Breaker Cash Offer," which will be used to determine the winning Bid in case more than one Bid have the same OWV.
8. **Offer Weighed Value (OWV):** Each Bid must include an economic proposal based on the Additional Royalty (AR) and the Investment Factor (IF). Such economic proposals will be analyzed based on the following formula:

$$OWV = 4 * \{ AR + [11.5*(AR/100) + 3.45]*IF \}$$

Where, IF = 1, if the Bid includes an additional investment offer equal to the work units for one well
 IF = 0, if the Bid does not include an additional investment offer equal to the work units of one well

Summary of the Model Form License

1. Term: The License will have a 35-year term with two Extension Options, the first for 10 additional years and the second for five additional years. Contractor will have to provide additional Development Plans for each Extension Term that must take into account production levels and field maturity.

2. Initial Transition Period: Sections 3.3 and 14.4 provide a 90 day period, starting on the Effective Date, for the CNH to deliver the Contract Area, the Asset Inventory (if any) and all applicable information to the Contractor. During this Initial Transition Period, the Contractor must perform Social and Environmental Assessments to establish the social and environmental baselines for the Contract Area and identify any Preexisting Damages. Furthermore, the Contractor must inspect all the assets and materials in the Asset Inventory and inform the CNH which will it retain and which should be abandoned or disposed by the previous operator. At the end of the Initial Transition Period, the Contractor will assume complete control and full responsibility for the Contract Area.

3. Exploration Phase: The Exploration Period will have a four-year duration from the Effective Date. Contractor must present an Exploration Plan for the Contract Area within 180 days after the Effective Date, which shall include the Minimum Work Program and the Additional Work program (if applicable). Rather than being an event of default, if the Contractor does not timely delivery the Exploration Plan, it will be subject to a per diem penalty. The license provides for two three-year Extension Options, subject to additional Work commitments for Work Units equivalent to one well for each Extension term.

4. Minimum Work Program: The License includes a Minimum Work Program that is reminiscent of the Multiple Service Contract model from 2001. The following table demonstrates how the program assigns a minimum level of investment by linking a fixed amount of units per activity to the depth drilled.

Contract Area	Surface Area (km ²)	Minimum Work Units	Well Units
Perdido Belt			
1	1,678.0	4,293	66,000
2	2,976.6	4,986	82,000
3	1,686.9	3,374	44,000
4	1,876.7	3,611	44,000
Cuenca Salina			
1	2,381.1	4,241	55,000
2	2,411.2	5,414	55,000
3	3,287.1	17,701	46,000
4	2,358.7	13,059	46,000
5	2,573.2	14,131	44,000
6	2,605.5	14,293	44,000

As a part of the Minimum Work Program, Contractor will have to allocate a number of units and the corresponding investment to specific activities that also have been assigned a fixed number of units. The next table illustrates some of the activities that have been assigned a fixed number of work units.

Activity	Unit	Work Units
Reprocessing 3-D NAz	km ²	0.70
Reprocessing 3-D WAz	km ²	1.25
Acquisition & Processing of 3-D NAz	km ²	2.50
Acquisition & Processing of 3-D WAz	km ²	5.00
Seismic Interpretation	Contract Area	250
Seismic Inversion & AVO Attributes	Contract Area	200
Synthetic Seismograms	Contract Area	180
Rock Modeling	Contract Area	235
Velocity Modeling	Contract Area	50
Regional G&G	Contract Area	200
Evaluation of Prospective Resources	Contract Area	150

5. Evaluation Phase: Contractor must declare an Evaluation Area and present an Evaluation Plan within 90 days after a Discovery. The Evaluation Plan must contain all Evaluation Activities, including at least all requirements listed under Annex 6, to be carried out during the three-year Evaluation Period.

6. Development Phase: After declaring a Commercial Discovery, Contractor has two years to present a Development Plan. Section 6.3 provides that the CNH will evaluate the proposal and Contractor's operating capacity of at least 10,000 boe per day in deep-water projects during any year within the last 10 years, which shall be certified by an exploration and extraction engineering firm.

7. Relinquishment: Under Article 7, Contractor must relinquish 100 percent of the Contract Areas without an approved Development Plan or that have not been declared an Evaluation Area after the Exploration Phase (or the corresponding Extension Terms if applicable). Similarly, Contractor must relinquish 100 percent of the Contract Areas at the end of the Evaluation Phase where no Commercial Discoveries have been declared or without an approved Development Plan.

8. Unitization: Article 9 provides an avenue for Contractors to notify and provide information to the Secretaria de Energia, Secretaria de Hacienda and the CNH to assess the proposed unitization of Contract Areas within a reasonable time frame. Contractors are to work with these entities and other Contractors to develop a Unitization Agreement that benefits all parties involved.

9. Guaranties: The License requires a performance guaranty that will secure the Minimum Work Program and any addition to the Minimum Work Program (if applicable). In case any of the extension options are exercised, the performance guaranty must be increased to secure such work commitments during the additional Exploration Period.

The License also requires each participating Contractor to provide a Parent Guaranty executed by the Contractor's parent company. The parent guaranty can be executed by the ultimate parent company or

the controlling parent entity of each participating consortium company. If the controlling parent company (as opposed to the ultimate parent company) executes the parent guaranty, it must demonstrate a net worth equal to the sum of its interest in the License and US\$14 billion. If non-operators are unable to meet these requirements, they are permitted to present audited financial statements consolidated for the last five years showing a net worth equal to five times the minimum work requirements and an investment grade rating.

10. National Content: Minimum national content (MNC) must be at least 3 percent for the Exploration Phase; increasing to 6 percent for the first additional exploration period and 8 percent for the second additional exploration period. The MNC for the development phase will start at 4 percent and will increase to 10 percent once regular commercial production begins.

11. Insurance: Section 20.2 lists the minimum insurance coverage that the Contractor must obtain, including general liability insurance; environmental liability and hydrocarbon pollution coverage, including mitigation, emergency response, site assessment, cleaning and remediation costs; well control insurance; equipment insurance and personnel insurance. The Contractor's policies must now cover all the subcontractors and providers that participate directly or indirectly in the Petroleum Activities.

12. Administrative Rescission: Similar to past model agreements, the License establishes a mechanism whereby the CNH can rescind the agreement in certain instances. Sections 23.1 through 23.3 contain the administrative rescission requirements for breach which is tied to Article 20 of the Hydrocarbon Law. These rights are tempered by a strict process that must be followed before any administrative rescission process can be commenced. In particular, Section 23.2 provides an investigative procedure that the CNH must carry out. This procedure may last anywhere between 30 days to two years depending on the administrative default. Once the CNH finishes its investigation, it must give written notice of its findings to Contractor if it elects to proceed with the administrative rescission process. The Contractor will then have 30 days to object and introduce additional evidence. The CNH will review all the materials and issue a final decision within 90 days. The Contractor has a right to cure the alleged default giving rise to the administrative rescission process until the CNH issues its final decision.

13. Contractual Rescission: Section 23.4 provides a 30-day period to cure any default after receiving written notice. Some of the default provisions include minor contract breaches, environmental damages, damages to personnel or noncompliance with Applicable Law.

Contact Information

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