

# Energy Alert

June 1, 2015

## Mexico’s Energy Industry

### Ronda Uno, First Tender

On May 29, 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 First Tender published on December 11, 2014 (the “First Tender”). The First Tender contains fourteen (14) exploration Contract Areas located in shallow waters in the Gulf of Mexico. Only a select group of companies will be able to benefit from these changes, however, as the deadline to qualify has passed. Next, is a list of the companies that have prequalified to participate in the First Tender:

#### Qualified Consortiums

BG Group Galp Energia	Talos Energy Sierra Oil & Gas Glencore E&P
Pan American Energy E&P Hidrocarburos	Tullow Petrobal
Murphy Ecopetrol Petronas PTT	Woodside Energy Diavaz Offshore Pluspetrol
Eni International Noble Energy CASA Exploration	

#### Qualified Individual Bidder

Atlantic Rim	ExxonMobil
BHP Billiton	Hess
Chevron	Hunt
Cobalt	Lukoil
CEPSA	Maersk Ollie
Marathon	Plains Acquisitions
Nexen Energy	Premier Oil
ONGC Videsh	Statoil
Pacific Rubiales	Total
Pemex	

This email alert discusses the most relevant changes in the Guidelines and Model PSC. The revised Model PSC appears to endeavor to centralize most interactions between the Contractor and the CNH, and significantly reduces the overall administrative burden on the Contractor. Overall, these modifications will have an immediate impact on the risk profiles for the shallow water projects and a long term effect on Mexico’s global competitiveness in future tenders.

#### Timeline

As shown on the timeline below, the CNH updated the schedule for the First Tender to provide additional time for the prequalified parties to submit additional questions regarding the tender process, the PSC

adjudication process or the Model PSC. Consequently, the CNH also set new dates to answer such questions and publish the final Guidelines and Model PSC.

#### Round 1.1 Bidding Process Timeline

- 12/11: CNH publishes Tender 1.1 and Bidding Process begins
- 3/17: Last day to make Data Room fee and request access to Data Room
- 3/25: CNH publishes revised Bidding Guidelines and Model PSC
- 3/31: Last day for interested parties to Registration fee and request prequalification appointment
- 4/17: Last day participating parties can submit documentation supporting prequalification requirements
- 5/20: Last day for CNH to review prequalification supporting documentation
- 5/25: CNH publishes Final list of Prequalified Parties
- 5/29: CNH publishes updated Bidding Guidelines and Model PSC
- 6/04: Last day to submit questions regarding Bids, Model PSC and Adjudication Process
- 6/08: Last day for CNH to answer questions regarding Bids, Model PSC and Adjudication Process
- 6/09: CNH publishes Final Bidding Guidelines and Model PSC
- 6/15: Last day to request authorization to include new non-prequalified Financing Parties to Consortium
- 6/29: Last day to request authorization to change Consortium structure and interests
- 7/6: Last day for CNH to grant authorizations regarding non-prequalified Financing Parties and changes to Consortium structure and interests
- 7/14: Last day to access Data Room
- 7/15: Bid envelopes are presented, opened and Tender winners selected
- 7/17: CNH Resolution announcing Bid Winners is published in the National Gazette
- 8/21: Last day to execute the Exploration PSC

### Bidding Guidelines

There were a variety of changes to the Guidelines, the most important ones are set forth below:

**1. Participation Format:** Under the revised Section 12.4 of the Guidelines, prequalified parties are provided substantially more flexibility in their ability to bid individually and in a consortium. For example:

“Licitante Agrupado” (a Consortium) may:

- incorporate a “Licitante Individual” as financing member to the Consortium (subject to forfeiting its classification as “Licitante Individual”);
- add companies that have not been prequalified as financing members; and
- reallocate Consortium interests among its members.

“Licitante Individual” may:

- join a Consortium as financing member (subject to forfeiting its classification as “Licitante Individual”); or
- join a Consortium as Operator (in this instance, it does not have to give up its classification as “Licitante Individual” but must become the Operator of the Consortium)

Operators in a Consortium may:

- participate and submit Bids as “Licitante Individual” as long as the Operators do not compete against its Consortium or any of its Consortium members (in case there are two (2) Operators in the Consortium trying to participate as “Licitante Individual”).

All changes or modifications to either the participation format or the Consortium members and their corresponding interests must be submitted to the CNH for approval in accordance with the timeline above. The CNH will provide its approval or denial by July 6.

**2. Bid Limit:** Bidders are no longer restricted to bidding on only five (5) Contract Areas. Section 15.3 of the Guidelines has been modified and prequalified participants may now Bid for all fourteen (14) Contract Areas, subject to the Participation Format changes and other applicable Guidelines.

**3. Limit on Participation Interest:** Under the revised Section 12.5 of the Guidelines, Consortium members may now hold a higher participating interest than the Operator, as long as the Operator owns at least one third of the total participating interest.

**4. Data Room Information:** Confidentiality agreements signed by potential bidders previously required bidders to destroy all information received from the Data Room. This requirement has been removed and bidders may now retain Data Room information, subject to all other conditions contained in the Confidentiality Agreement form.

**5. Bid Contents:** Under the revised Section 16 of the Guidelines, bids must now include a cash payment offer. This bonus payment will be used to determine the winning bid if the weighted score of the Economic Bid of two or more bidders is the same.

## **Model PSC**

There were a variety of changes to the Model PSC, the most important ones are set forth below:

**1. Initial Transition Period:** Section 3.4 calls for the CNH to deliver the assets and information it may have relating to the Contract Area within ninety (90) days of the Effective Date (the "Initial Transition Period"). During this period, the Contractor must perform certain social and environmental assessments to establish the baselines for the Contract Area and to identify any Preexisting Damages. Furthermore, the Contractor must inspect the assets made available with the Contract Area, 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.

**2. Non-Associated Gas and Sub-Salt Discoveries:** The Model PSC now incorporates special provisions for non-associated gas and pre-salt discoveries. For example, Section 5.4 provides that the Contractor has twenty four (24) months to evaluate a non-associated gas discovery with a twelve (12) month extension option (the standard evaluation period is twelve (12) months). Similarly, Section 7.4 allows the CNH to give special consideration to pre-salt discoveries and grant additional time to evaluate the area if necessary.

**3. Evaluation Plan and Development Plan:** The Exploration Plan due date has been extended from 60 to 120 days after the Effective Date. The Development Plan due date has been extended from

120 days to one (1) year after the Contractor declares a commercial discovery. The CNH has 120 days to approve these plans, request modifications, or they will be deemed to be approved.

**4. Relinquishment:** Section 7.1(d) provides that the Contractor will have to relinquish all of the subsurface and stratigraphic structures that are not included within a Development Plan within thirty (30) years from the Effective Date.

**5. Unitization:** Article 9 introduces a comprehensive change to the approach to unitization. Contractors now have a means to notify and provide supporting information to the *Secretaria de Energia*, the *Secretaria de Hacienda* and the CNH to assess the proposed unitization within a reasonable timeframe. The Contractors will work with these entities and other Contractors to develop a unitization agreement that benefits all parties involved.

**6. Reports and Administrative Paperwork:** The revised PSC simplifies the interface between the Contractor and the Mexican government, centralizing most interactions at the CNH. Furthermore, the amount of necessary reports and administrative paperwork has been significantly reduced. For example, Section 10.8 only requires quarterly progress reports regarding industrial and environmental safety. The elimination of “Presupuestos and Programas Indicativos” is another example of the reduction and simplification of the administrative procedures and paperwork.

**7. Liability for Preexisting Damages:** Section 14.4 provides 180 days for the Contractor to assess and determine the existence of any Preexisting Damages. The Contractor shall identify any preexisting environmental liabilities during this period and notify the CNH of any findings along with sufficient proof to support its claim. If Contractors proposal is accepted by the CNH and the Agency, the Contractor will not be responsible for any remediation or abandonment costs related to such claims.

**8. Corporate Guaranty:** A parent company guaranty is still required; however, the Guarantor may now be (i) the Contractor’s ultimate parent company, (ii) a company that exerts Control over the Contractor, or (iii) a company under the same corporate umbrella. In the revised Section 17.2, the Guarantor only has to demonstrate a net worth of \$6 billion dollars (no longer required to demonstrate this amount was in place during the last three (3) years). Finally, a new provision states that if the Guarantor is not the Contractor’s ultimate parent company, the Contractor must (i) notify the CNH within five (5) days if the Guarantor’s net worth falls below \$6 billion dollars and (ii) provide a new corporate guaranty backed by a Guarantor that does satisfy such requirement.

**9. Insurance:** Section 20.2 establishes the minimum insurance coverage that the Contractor must obtain, such as general liability coverage; liability insurance for environmental and pollution, including, emergency response, site assessment, cleaning and remediation costs; well control insurance; equipment insurance; and personnel insurance. The Contractor is no longer required to have its subcontractors obtain such coverage; however, Contractor’s policies must now cover all of its subcontractors and providers that participate directly or indirectly in the Petroleum Activities. Specific monetary and coverage requirements will be released later by ANSIPA.

**10. Force Majeure:** Section 22.2 underwent several changes. First, force majeure may now apply during the whole term of the PSC, not only during the Exploration Period. Second, the Contractor is entitled to request up to four (4) contract extension periods of three (3) months each due to force majeure. Finally, both parties will now have a right to terminate the PSC if an event of force majeure lasts for two (2) uninterrupted years.

**11. Termination Transition Period:** The new Section 18.7 provides a more descriptive list of things that the Contractor must do to transfer the Contract Area back to the State if the PSC terminates. This list includes updating the environmental and social baselines created during the Initial Transition Phase, as well as providing an updated Inventory of Assets to be transferred to the state, and to abandon any wells or materials the CNH does not want to retain.

**12. Administrative Rescission:** In recognition of the industry concerns regarding the potential for administrative rescission of the agreement, a new Section 23.2 sets up a process to provide certainty that the right will not be invoked capriciously or used as a hair-trigger to invalidate a PSC. Now, the CNH will carry out an administrative investigation process, specifically identifying its concerns and providing time for the Contractor to cure, before the Administrative Rescission process may begin. The CNH investigation may last anywhere between thirty (30) days to two (2) years, depending on the alleged administrative default. Once the CNH finishes its investigation, it will give written notice of its findings and, if deemed necessary, commence the Administrative Rescission Process. The Contractor will then have thirty (30) days to object and introduce additional evidence. The CNH will then have ninety (90) days to review all the materials and issue a final decision. It is important to note that the Contractor is able to cure any alleged default during this process until the CNH issues its final decision.

**13. Contractual Rescission:** Contractual rescission has been relocated to Section 23.4 and now provides the Contractor thirty (30) days to cure any default after receiving written notice. Furthermore, some of the default provisions were modified, including Sections 23.4(d) and (e), which now allow other members of the Consortium to substitute a member company or Guarantor in case one of the members is liquidated, becomes bankrupt, insolvent or otherwise unable to meet their obligations.

**14. Conciliation:** A comprehensive conciliation clause was incorporated into Sections 26.2 and 26.3. It provides the parties the opportunity to resolve any contractual dispute under UNCITRAL Conciliation Rules before submitting such dispute to arbitration.

**15. Fiscal Terms:** The fiscal terms in Annex 3 underwent two main changes to address current economic conditions while endeavoring to preserve a balanced profit distribution between the Contractor and the State. First, the formula to determine the Contractor's Operating Profit in Section 6 now includes a weighed value for Eligible Costs incurred as part of the minimum work program during the Exploration Period. Second, the formula values used to determine the Contractor's Operating Profit in the Adjustment Mechanism Formula in Section 8 increased from fifteen percent (15%) and thirty percent (30%) to twenty five percent (25%) and forty percent (40%), respectively.

**16. Overhead Costs:** The Recoverable Overhead Rate remained at one and a half percent (1.5%), but it only applies to administrative costs incurred outside of Mexico. Administrative costs directly related

to the Petroleum Activities in the Contract Area incurred in Mexico are now part of the Account Catalog and may be recoverable, subject to applicable law.

**17. Shared Infrastructure:** The new Annex 13 sets forth the guidelines regarding access and use of gathering and transportation infrastructure built under the PSC for reasonable compensation. While Annex 13 sets a maximum price formula to limit the access and use fees, it allows the parties to negotiate their own terms and conditions.

**18. Role of the Mexican Sovereign Wealth Fund (the “Fondo”):** The revised Annexes 3 and 11 create a clearer picture of the role of the *Fondo Mexicano del Petroleo* in the PSC. The Fondo will take production and operating expense information from the Contractor and it will calculate the consideration due to the Contractor and the State from production. The annexes provide steps to register the PSC and the parties involved in the Contract Area. In the future, the Fondo will provide a computerized system where the Contractor will submit all its production records, as well as all the recoverable costs. The Fondo will utilize the formulas contained in Annex 3 to determine each party’s share of production. Even though the specific guidelines and the system are still under development, these changes provide a glimpse into the Fondo’s role and likely interaction with the Contractors.

## Energy Alert

### Contact Information

If you have any questions regarding this alert, please contact:

**Steven P. Otilar**

[sotillar@akingump.com](mailto:sotillar@akingump.com)

713.250.2225

Houston

**Dino Barajas**

[dbarajas@akingump.com](mailto:dbarajas@akingump.com)

310.552.6613

Los Angeles

**Eduardo Canales**

[ecanales@akingump.com](mailto:ecanales@akingump.com)

713.250.2131

Houston