Mexico makes call for bids on 26 onshore blocks for hydrocarbon extraction and issues draft of contracts

On 12 May 2015, authorities in Mexico made a call for bids of 26 new onshore blocks for extraction of hydrocarbons (Round 1 - Onshore). The drafts of the terms and conditions for these bids, as well as the draft of the license contracts for extraction of hydrocarbons, are available at www.ronda1.gob.mx.
**Round 1 – Onshore – call for bids**

The map below shows the location of the 26 blocks which are part of Round 1 – Onshore, as well as a summary of their characteristics.

- Total surface area: 807.1 km²
- Two different type of blocks
  - Type 1: Less than 100 million barrels of residual volume of liquid hydrocarbons
  - Type 2: Equal or greater than 100 million barrels of residual volume of liquid hydrocarbons
Below is a summary of the most significant matters in the drafts of the terms and conditions of the bids and the draft license contracts for Round 1 – Onshore. This new information requires a comprehensive analysis and should be carefully reviewed based on the facts and circumstances applicable to each interested company.

**Bidding terms**

- No fixed block limit to bid, thus interested parties may bid for the 26 blocks if its registered equity is enough to cover such participation.
- Interested parties and bidders should not be in contact with any official from the National Hydrocarbon Commission (CNH) or the Mexican Government that is in any manner related to the Round 1 bidding, as bidding terms and contracts should not be subject to negotiation. However, any interested parties are able to make comments related to the bidding terms and contracts through CNH’s website.
- All stages of the bidding process will take place in Spanish.
- Bidding and contract terms, excluding prequalification requirements, are subject to change at any time before their final publication on 2 November 2015.
- The bidding process will occur in the following stages: i) publication of bidding terms, ii) access to data rooms, iii) registration, iv) clarifications to the bidding terms, iv) visits to the blocks, v) prequalification, vi) filing of proposals, vii) awarding of contracts and viii) execution of contracts.
- The following payments will apply:
  - Access to the data rooms: MXN$2.5m, which is significantly lower than previous biddings
  - Registry fee: MXN$280k
  - Per each proposal, the interested party should issue a standby credit letter to the CNH for US$65k for each Type 1 block and US$200k for each Type 2 block
- The chart below illustrates the timeline for the bidding process.

<table>
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<th>2015</th>
<th>2016</th>
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<td><strong>Biddings</strong></td>
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<td>May</td>
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<td>Publication 12 May</td>
<td>Updated terms 28 Aug</td>
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<td><strong>Data room</strong></td>
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<td>Term to request access (until 14 Aug)</td>
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<td><strong>Visits to contractual areas</strong></td>
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<td>Visits to contractual areas (until 11 Sept)</td>
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<td><strong>Clarification to bidding terms and contracts</strong></td>
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<td>Data rooms (until 7 Aug)</td>
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<td>Bids (until 23 Oct)</td>
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<td><strong>Prequalification</strong></td>
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<td>Pay registration (until 28 Aug)</td>
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<td><strong>Filing of prequalification documents (until 2 Oct)</strong></td>
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<td>Proposal openings 15 Dec</td>
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<td>Contract awarding 17 Dec</td>
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<td>Contract execution 8 Feb</td>
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Access to data rooms will be granted to companies engaged in exploration and/or extraction of hydrocarbon activities or companies that may participate as financing partners. Such companies may not be incorporated in Mexico.

Interested parties who prequalified for the prior biddings (Rounds 1.1 or 1.2) are not obliged to submit all the information requested to get access to the data room; instead, they should only submit certain CNH forms.

Optional visits to the onshore blocks are permitted for companies that have already paid to access the data room.

Only companies that have paid to access the data room, as well as their affiliates and their partners in consortium, are able to participate in the bidding process. To prequalify for the bidding process, companies have to demonstrate the following:

- Legal origin of funds.
- Personnel with sufficient technical capabilities and a minimum of 10 years of experience in onshore or offshore companies or personnel experience in industrial and environmental health and safety programs during the last five years. Interested parties who have prequalified for the prior biddings (Rounds 1.1 or 1.2) do not need to provide this information again.
- Economic capacity, meaning the operator needs to own a shareholder’s equity of at least US$5m for each block Type 1 and US$200m for each block type 2. Or, if going through a consortium, US$3m for each block Type 1 and US$120m for each block Type 2 (to the extent that at least US$80m of the shareholder’s equity is owned by two members of the consortium). Interested parties who prequalified for the prior biddings do not need to provide information regarding economic capacity, but will be subject to the number of blocks for which they intend to bid.
- For consortiums, the operator should have at least one-third of the economic participation, and no other partner can have more participation than the operator.

The bidding terms still prohibit two large oil companies (defined as having an average production of 1.6 MMboepd per company in 2014) from participating in the same joint venture or consortium. Also, restrictions to participate as only one group bidder per control group are maintained as in other previous bids, as are the similar restrictions on moving or merging consortiums.

The criteria for determining the winner will be a weighted average of the additional royalty, computed as a percentage of the contractual value of the hydrocarbons (90%), and the increased investment factor of commitment (10%). The value of the additional royalty should be greater than or equal to 100%, and the increased investment factor commitment should be greater than 100%.

License contracts for extraction of hydrocarbons

License contracts will apply for Round 1. Drafts of two different contracts were published: one for individual investors and the second for consortiums. The term of the contracts is 25 years with the possibility of two 5-year extensions.

The considerations the Mexican Government will receive pursuant to the license contracts are royalties and over royalties (bidding factor) in US$ and a quota for exploration in MXN. In exchange, the contractor will receive all produced hydrocarbons. The license contracts also include a mechanism of adjustment (R factor) determined according to the daily average production of hydrocarbons for the current period and the prior two periods.

License contracts establish an evaluation period. The initial term of the evaluation period is one year and may be extended for an additional year. During the evaluation period, contractors have to comply with minimum work commitments that will be expressed in...
working units. To be able to extend the evaluation period, contractors have to comply with the minimum work commitments, agree to comply with the additional work commitments and agree to carry out additional working units equivalent to the working units of one well. The contracts include penalties to the contractors for not complying with the minimum work commitments. Likewise, the contractors are obliged to execute a “compliance guarantee.”

- The license contracts will include a “start-up transition plan” for blocks that are already producing.
- 120 days after the evaluation period, contractors have to file a development plan with the CNH to continue their activities.
- A corporate guarantee is required at the moment the license agreement is executed. In case the guarantor is not the ultimate holding company, it has to be demonstrated that the guarantor’s equity is at least a certain amount (to be determined).
- As in the case of the shallow waters bids, the contractor should incorporate a trust (under control of CNH and the contractor) to fund abandonment provisions.
- Contractors are obliged to have an operating account for accounting purposes where all transactions related to compliance of the contractual obligations are registered. This compliance requirement, as well as other requirements related to procurement, may need to be adapted to a royalty license regime.
- License contracts include local content requirements for each phase of the project, as well as penalties for not complying with those requirements (to be determined). The local content will be set at 22% during the evaluation period. During the development period, local content will be at 27% during the first year with annual increases of 1% until it reaches 38% minimum in 2025.
- Regulations regarding the transfer of contractors’ rights under the license contracts are included.
- The methodology to determine the contractual price of hydrocarbons depends on the volume of commercialization of the contractor. In case the contractor does not commercialize more than 50% of the volume of hydrocarbons in a period, the contractual price will be determined according to certain formulas included therein. Also provided is a true-up and true-down adjustment, which is applicable in certain instances.
- Hydrocarbons should be measured at a measurement point (inside or outside the contractual area).
- Payments to the Mexican Government will be in cash. The contractors are in charge of the calculation of the Mexican Government’s consideration, and the payments will be made on a monthly basis on day 17 of each subsequent month. The hydrocarbons will be distributed on a continuous basis to the contractor to the extent it is up to date in its payments. However, hydrocarbons will be delivered definitively on day 17. If contractors do not make the corresponding payments to the Mexican Government, interest will be calculated (Interbank Equilibrium Interest Rate + 20%) and other penalties may apply.
- Contractors may not sell, lease or offer assets generated or acquired by the means of the license contracts.
- The license contracts require contractors’ financial statements to be audited by external auditors on an annual basis.
- A tax stabilization clause is included in the license contracts; however, such provision does not provide full protection to the contractors.
- License contracts include procurement rules that cover more than local content requirements; however, the compliance requirements do not depend on the amount of the transactions, as in prior contracts.
• Similar safety and environmental requirements to the ones included in contracts for shallow waters are included. The contractor will not be responsible for existing environmental damages in the blocks prior to the execution of the agreements.
• Rules for flaring, burning and self-use of hydrocarbons are included.
• The license contracts still include an administrative rescission clause, which is the right of the Mexican Government to abrogate the contract at any time due to a material breach.
• The depth of the contractual area is not as limited as in prior biddings.
• Some rules which make sense on a cost recovery contract are kept in a license contract, such as property of fixed assets and remaining balances on abandonment trust.
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