Mexico adjusts bid calendar of Round 1 shallow waters and calls for bids for extraction of hydrocarbons in shallow waters

On 27 February 2015, authorities in Mexico announced a modified calendar for bids on 14 blocks in shallow waters (Round 1 – Exploration). Terms and conditions for these bids and the original draft of the production sharing agreement for exploration and extraction of hydrocarbons are both expected to be amended accordingly. These changes will only be made to the documents published in the CNH (Comisión Nacional de Hidrocarburos, the National Hydrocarbon Commission) web page (www.ronda1.gob.mx) and no additional formal publication will be made. Authorities in Mexico also called for bids on five new blocks for extraction of hydrocarbons in shallow waters (Round 1 – Extraction).

Drafts of the terms and conditions for these bids and the production sharing agreement for exploration and extraction of hydrocarbons were also published. These documents are available in the CNH’s web page (www.ronda1.gob.mx).
## Round one – exploration – Calendar adjustment

In order to grant additional time to interested parties to prequalify for Round one – exploration and to evaluate their bids, the calendar was adjusted as follows:

<table>
<thead>
<tr>
<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dec</td>
<td>Jan</td>
</tr>
<tr>
<td>Biddings and PSC Terms</td>
<td>Publication</td>
</tr>
<tr>
<td>Data rooms</td>
<td>Term to request access</td>
</tr>
<tr>
<td>Clarification to bidding terms and agreements</td>
<td>Data rooms</td>
</tr>
<tr>
<td>Prequalification</td>
<td>Pay registration and schedule meeting</td>
</tr>
<tr>
<td>Results</td>
<td>Prequalification</td>
</tr>
</tbody>
</table>

### 2014:
- **Publication**: 11 Dec
- **Term to request access**: 16 Mar
- **Access to data rooms**: 14 Jul
- **Data rooms**: 20 Feb
- **Prequalification requirements**: 17 Jul
- **Biddings and PSC Terms**: Final Version

### 2015:
- **Publication**: 25 Mar, 29 May, 15 Jun
- **Term to request access**: 25 Feb, 23 Mar, 31 Mar, 8 May
- **Access to data rooms**: 27 Apr, 15 May
- **Data rooms**: 27 Apr, 15 May
- **Prequalification requirements**: 27 May, 1 Jun
- **Biddings**: 27 May, 1 Jun
- **Pay registration and schedule meeting**: 15 Jul
- **File prequalification documents**: 17 Jul
- **Review of prequalification documents**: 21 Aug
- **Prequalification**: 21 Aug
- **Contract awarding**: 17 Jul
- **Agreement execution**: 21 Aug
The authorities in Mexico announced that as of 27 February 2015, 43 foreign and domestic companies have shown interest in participating in Round one – exploration. Of those companies, 33 requested access to the data rooms, 25 have access and 16 are already prequalified. Mexican authorities expect additional players in the coming days.

Round one – extraction – calls for bids

Round one - extraction - block characteristics

- Nine fields divided in five blocks
- Total surface: 280.9 km²
- Total reserves: 1P – 143.33 MMbd, 2P – 355.31 MMbd and 3P – 671.31 MMbd
- Types of hydrocarbons: super light oil, light oil and heavy oil

Round one - extraction: shallow waters

Summary of significant issues: Terms & conditions & production sharing contracts: Round one - exploration

As the blocks available in Round one – extraction are in similar shallow waters as the blocks in Round one – exploration, the terms and conditions of the bids are similar. However, some adjustments were made, and certain clarifications were included. The following sections outline the main terms and conditions for Round one – extraction highlighting items that differ from the terms and conditions for Round one – exploration. The drafts of the contracts for Round one – extraction also contain differences from drafts of the contracts for Round one – exploration. The new information requires a comprehensive analysis and careful review by interested companies.
Bidding terms

- There is no limit to participation for the bidding; thus, interested parties may participate in the bids of the five blocks.

- Interested parties and bidders should not be in contact with any official from the CNH or the Government that is related to the round one bidding, as bidding terms and contracts should not be subject to negotiation. However, any interested party will be able to make comments related to the bidding terms and contracts through the CNH’s web page.

- All stages of the bidding process will take place in Spanish.

- Bidding and contract terms, excluding prequalification requirements, may be subject to change at any point in time before their final publication on 14 August 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, (v) prequalification, (vi) filing of proposals, (vii) awarding of contracts and (viii) execution of contracts.

The following payments will apply:

- Independent access to the data rooms – MXN$5,300,000
- Independent registry fee – MXN$280,000
- Access to data rooms will be granted to companies engaged in extraction of hydrocarbons or companies participating as financing partners. Companies with access to the data rooms of Round one—exploration will not be required to submit new information, but will only submit the forms requesting access to the new data room.
- Only companies that have paid access to the data room and their partners in consortium will be able to participate in the bidding process.
- Interested parties who prequalified for the bidding Round one—exploration need not provide all the information again to prequalify for this bid. Only specific information, mainly the production or extraction experience, should be provided.

The chart below illustrates the timeline for the bidding process.

<table>
<thead>
<tr>
<th>Biddings and PSC terms</th>
<th>Feb</th>
<th>Mar</th>
<th>Apr</th>
<th>May</th>
<th>Jun</th>
<th>Jul</th>
<th>Aug</th>
<th>Sep</th>
<th>Oct</th>
<th>Nov</th>
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<tbody>
<tr>
<td>Publication</td>
<td>27 Feb</td>
<td></td>
<td></td>
<td></td>
<td>Updated terms</td>
<td>12 Jun</td>
<td>Final version</td>
<td>14 Aug</td>
<td></td>
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</tbody>
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| Data Room              |     |     |     |     | Term to request access | (until 1 Jun) | Access to data room | (until 29 Sep) |     |     |
| Clarification to bidding terms and contracts |     |     |     |     | Data rooms | (until 5 Jun) | Prequalification requirements | (until 10 Jun) |     |     |
|                        |     |     |     |     | Biddings | (until 12 Aug) |     |     |     |     |

| Prequalification       |     |     |     |     | Pay registration and request schedule meeting | (until 15 Jun) | File prequalification documents | (until 3 Jul) |     |     |
|                        |     |     |     |     | Review of prequalification documents | (until 24 Jul) |     | Publication of companies | 31 Jul |     |     |

| Results                |     |     |     |     | Proposal openings | 30 Sep | Contract awarding | 2 Oct | Contract execution | 6 Nov |     |     |
• The bidding terms prohibit two large oil companies (as defined in the bidding terms) from participating in the same joint venture or consortium.

• The criteria for determining the winner will be a weighted average of the government profit oil share (90%) and the increased investment factor commitment (10%). Two examples were included to avoid any misunderstanding.

• Unlike the dollar amounts established as minimum work commitments in Round one – exploration, this bid establishes work units depending of the contractual area.

• Minimum government profit oil shares are still pending.

• In order to prequalify for the bidding process, companies have to demonstrate the following:
  • Legal origin of funds
  • Experience as an operator of projects from 2010 to 2014 through (i) participation in at least three production projects or (ii) investments in exploration and production of hydrocarbon activities of at least US$1 billion

• Experience in at least one production offshore project as an operator with a minimum proved production of 10 thousand bbl per day

• Personnel with sufficient technical capabilities with a minimum of 10 years of experience

• Experience in industrial, environmental, and health and safety programs during the last five years

• Economic capacity, meaning the operator needs to own assets of at least US$10 billion and have an investment credit rating, or shareholder’s equity of at least US$1 billion or US$600 million if going in as a consortium, and the remaining US$400 million are supported by its partners

• 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.
PSCs for extraction of hydrocarbons

- As in the case of Round one – exploration, PSCs will apply for Round one – exploration. Drafts of two different contracts were published: one for individual investors and the other for consortiums. Likewise, as in the case of Round one – exploration, the term of the contracts is 25 years with the possibility of two 5-year extensions and a cost recovery limit of 60%. The contracts for Round one – extraction include further clarifications on the cost recovery and on the eligible costs.

- PSCs establish an evaluation period. The initial term of the evaluation period is two years and may be extended for one year subject to compliance with the requirements established therein. During the evaluation period, contractors have to comply with minimum work commitments and increase in work commitments as established in the PSC.

- Considering that blocks are for extraction of hydrocarbons, the PSC includes a start-up transition plan, whereby the CNH is obliged to provide a draft of a start-up transition plan to the contractor for its approval. If the CNH or the contractors do not agree on the start-up transition plan, the agreement will be automatically terminated.

- As in the case of the PSCs applicable for Round one – exploration, the draft PSCs for Round one – extraction also include provisions for guarantees for work commitments.

- A corporate guarantee is required; however, the PSCs include additional details on the company that may be the guarantor. An ultimate parent company guarantee might not be required if any other affiliate has US$6 billion in shareholder’s equity and is willing to act as guarantor.

- Annual work plans will have to be submitted by the contractors to the CNH. The PSC establishes cases where the CNH can disapprove the work plan.

- As in the case of the PSCs applicable for Round one – exploration, the contractor must establish a trust, under the control of the CNH and the contractor, to fund abandonment provisions. The factors of the formula included in the PSC for Round one – extraction differ from the factors included in the PSC for Round one – exploration, but the formula still has some issues that require a more detailed analysis.

- The PSCs clarify that the functional and reporting currency is the US dollar for all purposes; however, they establish the obligation to maintain accounting in Mexican pesos.

- As in the case of the PSCs applicable for Round one – exploration, the PSCs for Round one – extraction include local content requirements for each phase of the project as well as penalties for not complying with those requirements. The local content will be 17% during the evaluation period.

- During the development period, local content will be 25% during the first year with annual increases of 1% until 35% in 2025.

- Regulations regarding transfer of contractor’s rights under the PSCs are similar to those included in PSCs for Round one – exploration. New PSCs contain more detail for the change of operator in case of a consortium.

- The PSCs define the methodology to determine the contractual value of hydrocarbons. Determining the value of the hydrocarbons differs significantly from the calculations included in the PSC for Round one – exploration. The mechanism of adjustment (R factor) is determined according to the operating profit margin of the contractor, and the PSCs include a formula for determining the adjustment.

- The R factor included in the PSC for Round one – extraction defers to the R factor included in the PSCs for Round one – exploration. Internal rate of return (IRR) thresholds were increased from 15%-30% to 20%-35%, and minimum adjusted profit split to the contractors increased from 20% of the original offer to 25%.

- Payments under the contracts to the contractor and government will be made monthly on the 17th. In contrast to the PSCs applicable to Round one – exploration, PSCs for Round one – extraction include clarifications on the distribution of the hydrocarbons. Distributions of hydrocarbons will be continuous at the measurement point based on the prior month’s distributions among the parties.

- As in the case of the PSCs applicable for Round one – exploration, contractors are required to keep a registry of the costs, expenses and investments. However, the PSCs for Round one – extraction include additional details on the accounts, mechanic of registry and supporting documentation required.

- As in the case of the PSCs applicable for Round one – exploration, additional exclusions were included for cost recovery purposes, in addition to the ones included in the Hydrocarbons Revenue Law. Limitation to recover indirect administrative expenses or overhead increased from 0.25% of annual budget to 1.50%.

- The PSCs also require the contractor’s financial statements to be audited annually by external auditors, and the audit’s cost will be eligible for cost recovery. Additional regulations regarding audits are included.

- The same tax stabilization clause as the one included in the PSCs for Round one – exploration was included. This provision may not guarantee full protection to the contractors.
New specific rules applicable to transactions carried out with related parties are included.

More detailed regulations on procurement are included in the PSCs applicable to Round one – extraction, and additional compliance rules apply.

The same safety and environmental requirements as those included in PSCs for Round one – exploration are included. The contractor will not be responsible for environmental issues existing in the blocks prior to the execution of the agreements. The contractor must have valid insurance to cover all operation and environmental risks at all times. The PSCs applicable to Round one – extraction establish that insurance can be obtained with affiliated companies subject to compliance with certain conditions.

The same rules as those included in the PSCs applicable to Round one – exploration for flaring, burning and self-use of hydrocarbons without compensation to the government are included. However, further clarification is still needed.

Rules identical to the ones included in the PSCs applicable to Round one – exploration for disputes are included; however, additional detailed regulations were included in respect to audits carried by the Ministry of Treasury.

The procedures for the administrative termination of the contracts are consistent with the hydrocarbons law. More detailed regulations on the administrative termination procedure are included in the PSC for Round one – extraction.

Industry feedback

It is worth mentioning that the drafts of the PSCs applicable to Round one – extraction already include amendments and clarifications derived from the comments made by industry participants to the corresponding authorities on the PSCs applicable to Round one – exploration. Such adjustments include clarifications on the formulas, modifications in the R factor, clarifications of the corporate guarantee and limits on the cost recovery, among others. This demonstrates that the authorities in Mexico are open to suggestions and are committed to implementing energy reform according to market standards and the economic environment.

Industry participants are encouraged to continue providing comments and feedback as all documents are still under review.
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