

# Client Alert

Global Transactions Practice Group

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## Mexico: E&P Regulator Issues First Call for Bids under Round One

### *CNH-R01-L01/2014*

The Comisión Nacional de Hidrocarburos (CNH) has issued the first call for bids under Round One and the terms and conditions (T&Cs) governing the tender. CNH seeks to award 14 production-sharing contracts for the exploration and production (E&P) of hydrocarbons in 14 areas located in shallow waters offshore the States of Veracruz, Tabasco and Campeche (Gulf of Mexico). Additional tenders for the E&P of extra-heavy hydrocarbons and hydrocarbons located in the deep-waters of the Gulf of Mexico, shale plays and mature fields will be made during the first semester of 2015, also as part of Round One.

The 14 areas being auctioned by CNH under this call contain light crude and range from 116 km<sup>2</sup> to 500 km<sup>2</sup>. All are exploration-first areas, meaning that each contractor will have to explore for hydrocarbons, and if such hydrocarbons are found in commercial quantities, proceed to produce hydrocarbons in accordance with a development plan.

For more information, contact:

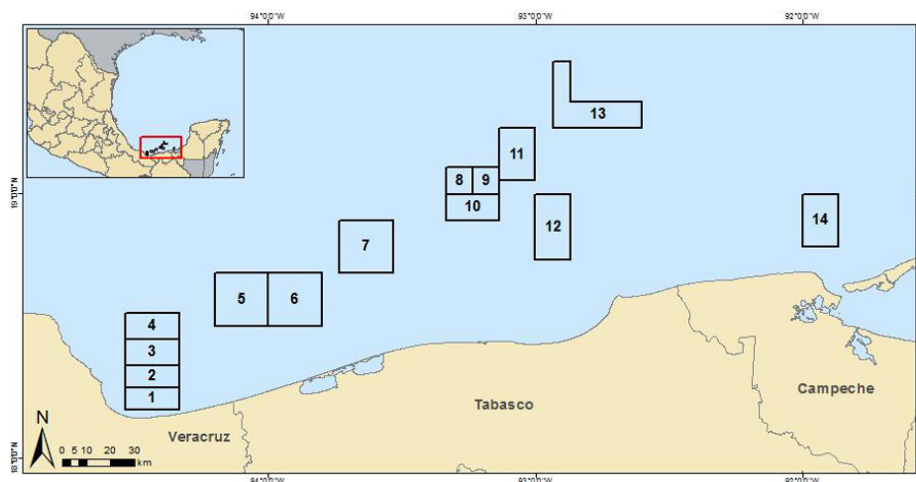
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Source: CNH

### **Bidders**

Round One is open to all foreign and domestic companies, including Pemex, and each such company may bid individually or as part of a consortium.

Each bidder will need to prequalify on the basis of its technical and financial capabilities.

As part of the prequalification process, the bidding operator must prove to CNH that it:

- has between 2010 and 2014 participated in at least three E&P projects, or alternatively, in at least one E&P project in which the total capital investment was at least one billion Dollars;
- has operated at least one shallow-water E&P project or been a partner in at least two shallow-water E&P projects in the last five years;
- will employ key management/operational personnel for the project with at least 10 years of experience in shallow-water projects (all of whom must be approved by CNH); and
- has experience in the management of industrial security and environmental protection in accordance with international practice and standards (including OHSAS 18001, ISO 14001, API RP 75 and ISM Code).

The bidder must also prove to CNH that it has a net worth of at least one billion Dollars; *provided* that if the bidder is a consortium (a) the net worth requirement must be met by no more than three members, (b) the operator must have a net worth of at least 600 million Dollars and hold at least one third of the participating interest in the project and (c) no other consortium member has a participating interest in the project that is greater than the operator's participating interest. Alternatively, the operator may show that it has an investment grade rating (Fitch, Moody's and S&P) and assets valued at 10 billion Dollars at a minimum.

The T&Cs also state that no company may participate in more than one consortium during the bidding process. Furthermore, companies that produce over 1.6 million barrels of crude oil equivalent per day may not join a consortium as members, and no company or consortium may bid for more than five blocks. This last limitation will not apply in future, high cost projects such as deep-water projects.

## **Bidding Process**

CNH will open its office to all interested bidders during the week of December 15, 2014. On such date bidders will be able to purchase the T&Cs, commence the prequalification process by setting up an appointment with CNH, and file an application to access the data room, which will make available to bidders all the information held by the government for all contract areas, including 2D and 3D seismic, geologic studies and a description of existing infrastructure and investments.

The prequalification process ends on April 23, 2015.

Access to the data room will commence on January 15, 2015 and end on July 15, 2015, the date on which all bidders must submit their bids in a sealed envelope to CNH.

Bidders will have the ability to make observations to and request that CNH clarify any matter relating to the T&Cs, the prequalification process and the manner of accessing the data room, and while the prequalification requirements may not be modified or waived by CNH, the T&Cs, including the form of contract attached thereto, will be subject to revision. In an effort to ensure a transparent bidding process, all observations and clarifications must be made in writing and electronically by all interested parties, and CNH will publish any such observation or clarification as it is made. This means that no bidder will be able to meet in person or have direct contact with any specific representative of CNH to address matters relating to the tender.

CNH will publish the final T&Cs on June 15, 2015.

All bids will be received and opened, and all awards made, in a public act to be aired live through the Internet at <http://ronda1.gob.mx/> on July 15, 2015. All contracts will be executed the following day.

Each contract will be awarded to the bidder who proposes the highest production share to the State (weighted at 90%) and the highest level of committed investment that is over and above the minimum work obligation (weighted at 10%).

Ties will be broken by the bidder who proposes the highest additional cash payment to the State, and failing such tie breaker, by the bidder whose name is drawn from a sack.

## **Form of Contract**

The forms of contract for individual and consortium bidders are fundamentally the same. The following is a general description of a few selected features of the forms of contract:

### *Term*

- Each contract has a 25-year term, with two optional 5-year extensions.
- Each 5-year extension is subject to approval by CNH.

### *Exploration Phase*

- Each contract will have an initial exploration phase of three years that may be extended for two more years upon approval of CNH.
- Within 45 days following the execution of the contract, the contractor must propose:
  - an exploration plan that contains a minimum work program (ranging between \$57 million and \$150 million, depending on the block) and programs for the transfer of technology and risk management; and
  - an annual work program.

### *Evaluation Phase*

- If a discovery is made, the contractor may propose up to two, 12-month evaluation plans.

### *Production Phase*

- If a discovery is made in commercial quantities, the contractor must propose:
  - a development plan that contains a description of the activities to be performed by the contractor during such phase, as well as programs for the transfer of technology, enhanced recovery and risk management; and
  - an annual work program.

### *Relinquishment*

- The contractor must relinquish:
  - 50% of the areas it has not developed by the third year of the term;
  - 50% of the remaining areas by the fourth year of the term; and
  - 100% of the remaining areas by the fifth year of the term.

### *Rescission*

- The contract may be rescinded by CNH:
  - for any reason stated in Article 20 of the Hydrocarbons Law; and
  - for any reason described in the contract, including for any act of corruption.

### *Applicable Law and Dispute Resolution*

- All contracts are governed by the laws of Mexico.

- All cases relating to the administrative rescission of contracts must be submitted to the federal courts of Mexico.
- All other disputes will be subject to international arbitration at the Hague in accordance with UNCITRAL Arbitration Rules.

## *Assignments*

- All assignments require the prior written consent of CNH.
- In the event the contractor assigns 100% of its interest, the assignee will be jointly and severally liable with the assignor for all of the obligations under the contract.

## *Fiscal Terms*

- Contractor will be required to make the following payments to the government:
  - for the first 60 months of the term, delay rentals in an amount equal to \$1,150 Pesos per km<sup>2</sup>, and for the remainder of the term, delay rentals in an amount equal to \$2,750 Pesos per km<sup>2</sup>;
  - the State's share of production as proposed by the bidder (which may not be less than the minimum share set forth in the T&Cs);
  - overriding or additional royalties at the rate specified in the Hydrocarbons Law (subject to adjustment for windfall operating profits);
  - income taxes at a rate of 30%; and
  - during the exploration phase, an E&P tax equal to \$1,500 Pesos per km<sup>2</sup> being explored, and during the production phase, an E&P tax equal to \$6,000 Pesos per km<sup>2</sup> being exploited.
- Cost recovery commences upon production and is capped at 60% per operating period, provided that costs that are unrecoverable for such period as a result of the cap may be carried forward to subsequent periods.
- Ring fence rules apply at the industry and contract levels for purposes of calculating income tax.

## *Contract Administration*

- CNH, on behalf of the Mexican government, will directly administer all contracts.
- The Secretaría de Hacienda y Crédito Público will audit all cost recovery.
- The Secretaría de Economía will audit the performance of all contractual obligations with respect to national content.
- The Agencia Nacional de Seguridad Industrial y Protección al Medio Ambiente will ensure that all projects are operated in accordance with all laws applicable to industrial security and the protection of the environment, and audit the contractor's performance of the risk management program set forth in an exploration or development plan.

In due course, we will provide an analysis of the T&Cs and the provisions contained in the form of production-sharing contract attached to the T&Cs, as they compare to international practice.



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