

Alert | Energy & Natural Resources/Infrastructure

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CNH Issues Round 3 Bidding Guidelines for Exploration and Production in Shallow Waters

On Sept. 29, 2017, Mexico's National Hydrocarbons Commission (CNH) published the guidelines and model contracts for the first bidding process of "Ronda 3" (Round 3.1). Round 3.1 includes 35 exploration and production (E&P) contractual areas in shallow waters in the Gulf of Mexico, with a total surface of 26,265 km² (10,140 mi²), approximately 1,988 million barrels of crude oil equivalent (MMBOE), and a remaining volume of 290 MMBOE. The contractual areas included in the bid are as follows:

- 14 contractual areas located in the Burgos area, with a surface of 8,424 km² (3,252 mi²), and 579 MMBOE of estimated prospective resources.
- 13 contractual areas located in the Tampico-Misantla-Veracruz area, with a surface of 12,493 km² (4,823 mi²), 1,217 MMBOE of estimated prospective resources, and a remaining volume of 193 MMBOE.
- 8 contractual areas located in the Southeast Basin area (*Cuenca del Sureste*), with a surface of 5,348 km² (2,065 mi²), 192 MMBOE of estimated prospective resources, and a remaining volume of 96 MMBOE.

Round 3.1 represents Mexico's largest E&P bid process to date, as the CNH has never tendered more than 35 contractual areas in one process. According to the CNH, the contractual areas include light to heavy crudes, as well as wet and dry gas blocks which may represent at least 70 percent of the total estimated shallow water prospective resources included in the 2015-2019 five-year program. The contractual areas are spread over the main oil production areas in the Gulf of Mexico and interact with some of the previously awarded areas as well as the recently announced **PEMEX farm-out areas**. The creation of these

regional clusters may promote the development of value chains and infrastructure due to the closeness of the contractual areas within the Gulf of Mexico.

Key Features Regarding the Bidding Process

The bidding process will include the following phases:

a) Publication of Bid Document

The invitation to bid number CNH-R03-C01/2017 for the bid process CNH-R03-L01/2017 was published on Sept. 29, 2017, in the Mexican Federal Official Gazette.

On the same date, the CNH published the Bidding Guidelines and the forms of Production Sharing Agreements.

b) Access to Data Room

Access to the data room will be through the National System of Hydrocarbons Information. In order to obtain access to the data room, bidders are required to pay a fee of MXP \$8,000,000.00 (approximately USD \$440,000.00) to obtain a license to access the information regarding wells and 3D/2D seismic studies.

c) Registration

In order to participate in the bid, interested parties are required to register with the CNH and pay a registration fee. The registration fee is MXP \$750,000.00 (approximately USD \$41,000.00).

d) Questions and Answers (Q&A)

Bidders may submit questions to and request clarifications from the CNH through a public Q&A process, which will occur in three phases. The first phase will address issues regarding the fees for accessing the data room and registration of interested parties, respectively; the second phase will address issues related to the prequalification and conformation of bidders; and the third phase will address issues in connection with the submission and opening of proposals, award, and the Production Sharing Agreement.

e) Prequalification

All operators or non-operators are required to be prequalified. Bidders may participate individually or as a consortium formed by operators and non-operators. In order to be prequalified, bidders must comply with certain technical, financial, execution, and legal capabilities, similar to other bidding processes issued by the CNH.

According to the Bidding Guidelines, there are certain requirements for bidders to meet in order to prequalify and they differ depending on whether the companies are applying as an operator or non-operator. Once bidders are prequalified, if applicable, they must obtain an authorization from the CNH to form the corresponding consortium and participate as bidders, indicating the designated operator (which must have a minimum of 30 percent of participating interest in said consortia), with the understanding that the selection of the members of the consortia will be carried out by the bidders.

Pursuant to the Bidding Guidelines, among the technical capabilities to be complied with, operators will have to provide evidence of their participation in at least one shallow waters E&P project during the last five years or a total capital investment in shallow waters E&P projects of at least USD \$1,000 million. In addition, operators must provide evidence of experience in the implementation and operation of Health, Safety, and Environmental (HSE) systems during the last five years and submit one of the corresponding certifications in this regard.

Regarding financial capabilities, operators must provide evidence of a net worth of USD \$1,000 million or assets with a value of USD \$10,000 million, as well as show that they have a credit rating with an investment grade (Fitch Ratings, Moody's Investors Service, or Standard & Poor's Rating Services, or HR Ratings). Non-operators must provide evidence of a net worth of USD \$250 million.

Bidders who have previously been prequalified with respect to financial and technical capabilities in other tenders issued by the CNH in connection with E&P activities may state under oath that there have been no changes in the documents submitted in the corresponding prior tender instead of resubmitting the same information.

f) Opening of Proposals and Award

All bidders are required to provide a bid guarantee of USD \$500,000.00 through a letter of credit for each one of the contractual areas of interest.

The Ministry of Public Finance will determine the minimum and maximum amounts applicable to this process.

The successful bidder will be selected based on the bid that offers the highest economic proposal based on the amount of the operating profit payable to the Mexican State (the result of subtracting the amount of royalties and cost recovery from the contractual value of hydrocarbons corresponding to each period) and the highest compromise of additional investment, up to two wells. If there is a tie between two or more bidders, the successful bidder will be selected based on the bid that offers the highest signature bonus to the Mexican State.

g) Production Sharing Agreement

Once the CNH has selected the successful bidder, CNH and the bidder will enter into the Production Sharing Agreement. The Production Sharing Agreement will include, among others, the following terms and conditions:

- 30 year term with two potential extensions of 5 additional years each, subject to the progress of extraction of hydrocarbons activities inside the contractual area.
- Compensation Adjustment – The agreement includes a compensation adjustment mechanism, which increases the payments in favor of the Mexican State in case of prices, production, or cost efficiency windfalls.
- Cost recovery – This is subject to a limit of 60 percent of the income of the corresponding period; 80 percent if there is only a gas discovery. The remaining can be transferred to subsequent periods.
- Exploration Period – Four years with two optional additional periods of two years each.
- Evaluation Period – Two years.

- Development Period.
- Surrender of the area.
- Unitization.
- Work programs and budgets.
- Disposition of production.
- Compensation.
- Performance and corporate guarantees.
- Abandonment and decommissioning.
- Insurance.
- Local Content (15 percent in the exploration period¹; 17 percent in the evaluation period²; and 26 percent in the development period, to be increased annually up to 35 percent in 2025³).
- Administrative and contractual rescission.
- Assignment and change in control.
- Applicable Law (Mexican law) and Dispute Resolution (arbitration, except for administrative rescission – UNCITRAL Arbitration seated in The Hague, Netherlands).

Authors

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**Special thanks to Daniel Pimentel Zaga[†] for his valuable contribution to this Alert.*

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¹ Except for areas 8, 19 and 32 with 13 percent.

² *Id.*

³ Except for areas 8, 19 and 32 with 12 percent to be increased annually up to 17 percent in 2015.

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