

Arturo Henríquez

President, Pemex Procurement International, Inc.
Corporate Director of Procurement of Petróleos Mexicanos



ARTURO HENRIQUEZ is the President and CEO of PEMEX PROCUREMENT INTERNATIONAL, INC.¹ He has graduate degrees from the Kellogg Graduate School of Management and Boston University. In January 2013 he was appointed President and CEO of Pemex's strategic procurement office in Houston. On January 17, 2014, he was named to lead Pemex's new centralized procurement department in Mexico City.²

Pemex Procurement International, Inc. is the successor company to International Trade Systems, Inc. (ITS), which operated under that name for some twenty years in Houston as Pemex's strategic procurement office. ITS served Pemex's business units as a convenient procurement vehicle by which special goods and services could be acquired, with the vendor paid in Houston in U.S. dollars. One of the premises of ITS was that its venue and business culture would attract manufacturers and service providers who, otherwise, would not make their products available in Mexico.

ITS itself, could not initiate a business relationship with Pemex; it would have to be requested by a business or administrative office in Mexico. ITS had a database of vendors, and with some of these there were framework agreements in which, in advance of a procurement need, the documentation and terms and conditions would be previously negotiated. In this way, when the need arose, there would be minimal delay. ITS would charge Pemex a small commission on each transaction.

In 2013, ITS's name was changed to Pemex Procurement, Inc., and Arturo Henríquez was named as the new president. On January 7, 2014, Mr. Henríquez gave a presentation in Houston on the outlook for procurement in Pemex. This interview was inspired by his presentation, and reflects additional conversations with him.

Mexico Energy Intelligence (MEI). Our subscribers, as well as visitors to our website, energia.com, will appreciate your giving the extra time to meet with us to talk about how you see the issues of procurement under the new oil regime and under a restructured Pemex.

Arturo Henríquez (AH). I'm glad for the opportunity to contribute to your binational, public-interest reporting about Mexico's energy sector, and in particular about Pemex. It means a lot to me that there are venues such as yours where Mexican concerns and perspectives may be set forth for an English-speaking audience in a friendly, informal manner. Now let's dig into the matter of procurement.

¹ <http://pemexprocurement.com/about/management/arturo-henriquez/>

² http://www.pemex.com/prensa/boletines_nacionales/Paginas/2014-006_nacional.aspx#.UuwtV8akpfc

MEI: Please explain why a change in Pemex’s procurement system needed, and how to you see a new system emerging?

AH: Changes are needed because, at present, the procurement system is very inefficient, with waste measured by duplication, delays, unnecessary paperwork and lack of leadership. When you are dealing with an annual budget of some US\$60 billion, then just inefficiency that costs you 10% is a big number. At present, there are some forty purchasing centers in Pemex, each with its own independent database of vendors. In one database a vendor will have one vendor number, but in another database he will have another. And so on.

Then there is the matter of inventory. The principle of Just-In-Time (JIT) inventory management in Pemex is conspicuous by its absence.

So, you can see that our vision is to centralize information so that there is one database of vendors, not forty, and that the duplication of information and paperwork may be reduced.

MEI: In Houston, as in Mexico, there is a muddy discussion about corruption in relation to Pemex. For many years now I’ve said that “in Mexico, the discussion of corruption is itself corrupt.”

AH: You refer to our two-faced attitude in Mexico regarding corruption. We see nothing wrong with paying a police officer 500 pesos if he stops us for a traffic violation late at night; but we see everything wrong with a system in which police officers are required to collect a certain amount of such bribes daily so that their superior officers may receive money.

We Mexicans complain of corruption in a system that we ourselves are corrupting. It’s a cultural paradox.

But, as for Pemex, we want to find ways to simplify and centralize data and paperwork, and to anchor procurement decisions in real-world economics of scale and global competition.

MEI: In your presentation at the Petroleum Club, you used a term with which I was unfamiliar: “Category management.” Please tell us what that’s all about.

AH: The simple idea here is that we want to develop specialists in Pemex in distinct areas of procurement.

Note: The appointment of Mr. Henríquez as the new Corporate Director of Procurement in Pemex ten days after our original interview has complicated his schedule to the extent that for the foreseeable future he is unavailable for a follow-up meeting in which additional topics could be explored.

Aprueba el Consejo de Administración de Pemex la creación de la Dirección Corporativa de Procura y Abastecimiento

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**Permitirá generar ahorros en los procesos de compra y no implicará aumento de personal
Arturo Henríquez Autrey estará al frente de esta nueva área**

El Consejo de Administración de Petróleos Mexicanos aprobó hoy la creación de la Dirección Corporativa de Procura y Abastecimiento (DCPA), la cual centralizará las compras relacionadas a bienes, servicios y arrendamientos operativos y de obra pública de todo Pemex, lo que permitirá un mejor aprovechamiento del poder de compra de la empresa a fin de generar ahorros y desarrollar procesos estandarizados, ágiles, oportunos y más transparentes.

What follows is a speculative dialogue that reflects our appreciation of the knowledge, constraints and ambitions of someone from the outside the career ranks of Pemex who has been given this heavy responsibility. We do not speculate on how Mr. Henríquez himself might address any of these collateral topics; so the initials [PPI] refer, generically, to what an official in his position might say—or not say.

PPI: Let me express a wish, also, that in your questions you will include some of the background that prompts you to ask the question. I'm curious about your views about different aspects of procurement, as you have been following and writing reports about Pemex—since forever.

MEI: Thank you. As an occasional vendor—sometimes unpaid-- to Pemex, I have my own successes and “war stories” to draw on.

PPI: Unpaid?

MEI: Sometimes you do something because you are in a position to help, regardless of being paid or not. On two occasions early in the Fox administration, when Raúl Muñoz Leos was director general—and when all of us were thrilled by the possibility of a market-oriented energy reform--, I was asked to help with the English translation of Pemex's annual report. On the first occasion, I was asked to edit a draft translation by the IMP; the document that I returned were covered with my corrections. The next year, I received a call from the same Pemex office, asking “*How are you coming with the translation?*” At that time, I knew nothing about it, so I asked if a draft had been sent to me. “*No, we want you to start fresh, as we don't want to go through the experience of last year again.*” I worked for two weeks on that translation, and proposed several ideas to standardize the translation process in the future. There was no follow-up, however, and the matter of my being given a contract was never brought up.

PPI: That's an interesting story, both about you and about the informal procurement processes that take place in Pemex that are never documented and never lead to improvements in the procurement process. We are hoping to reduce such informalities in the future.

MEI: Let's turn to your company, **Pemex Procurement International**. Please tell us, in the first place, why the change of name? For twenty years, neither “**Pemex**” nor “**Petróleos Mexicanos**” was listed in the Houston telephone directory. People would call me, asking for Pemex's telephone number.

I was later told that that the Pemex office that was in Houston in the 1980s that was called ORPH (Oficina de Representación de Pemex en Houston) had been the subject of several lawsuits, not against the company itself, but as a legal maneuver to sue Pemex in U.S. courts. As a measure to avoid such legal exposure, in the early 1990s **International Trade Systems, Inc.** (ITS), was established as a U.S. company that was owned by a shell company subsidiary of **PMI Comercio Internacional**, Pemex's trading department.

[PPI]: It's a long story—and I'm not familiar with all the details—but the short version is that today Pemex wants to projects its image and presence internationally. You have read, I'm sure, that **PMI** has opened an office in Singapore.

MEI: Interesting that you should put it that way. Recently, we received a call from a consulting company in Mexico City that had a contract with Pemex to interview opinion leaders about the Pemex brand. The

first question was this: “What comes first to your mind when you hear the words ‘Petróleos Mexicanos’? I’m sure that my reply was unexpected: I said, “*Pemex 2.0*,” and explained that a future Pemex, S.A. would eventually be needed.

PPI: You are ahead of the political curve in Mexico by one or two presidential administrations.

MEI: The Energy Reform of 2008 created a dual procurement system in Pemex that was well intended, but somewhat artificial. At last—and it took decades—Pemex convinced the government authorities that the oil industry was different from others in that it was common for unexpected problems or challenges to arise that would be impossible to handle under the Public Works Law (LOPSRM) or the Government Procurement Law (LAASSP). Those laws required a government agency—not just Pemex—to hold a public tender in which the objective, timeframe, approach and materials were specified. The agency that had sponsored the tender would then be required to choose the bidder with the lowest price.

Well, as the whole world saw in the Macondo oil spill of 2008, no one had any idea of how to plug an oilwell that was flowing 30,000 b/d at a water depth of 8,000 feet. It had never been done before. So the whole set of premises that underlay the Public Works Law were clearly seen as invalid for much of the oil industry.

PPI: Yes, in the new Pemex Law a new procurement concept was introduced: the core activity that, in matters of procurement, would be exempt from the rules of the LAASSP. The concept of “core activity”—as I’m sure that in your reports pointed out—had shaky legal foundations, and was difficult to administer. Still, on January 6, 2010—three long years ago—the Special Procurement Guidelines were issued by the restructured corporate board of directors. I’m not saying that you needed to be Aristotle to understand these guidelines, but they were a long way from being straightforward.

Further, there was an awkward detail that some observers noticed: By virtue of Article 52, the procurement of a piece of equipment that might be needed to construct an office building would fall under the LAASSP; but the same piece of equipment that would be needed for a “core activity” would fall under Article 51 of the Pemex Law.

MEI: That was not the only problem. We noticed that even in those contracts that were issued under Article 51, the rule of “lowest price” was applied in making the award. We urged the contracting office to consider what, in the U.S. Government, is called “Total Value Procurement,” and we argued that Constitutional Article 134 requires that government offices take into account multiple factors in addition to price, such as timeliness and financing.

PPI: I am more comfortable with the term “full-cycle costing.” But tell me, why do you think that Pemex contracting offices used the factor of price to make an award?

MEI: It turns out that it was not only price, but “investment commitment.” There was a justly famous moment in August of 2011 in the first bid round under the new Procurement Guidelines in which the bidders—**Petrofac** and **Schlumberger**—had a technical tie on price. The tie-breaking criterion was the percentage above the minimal investment commitment to which a bidder was willing to commit in a given block. The minimum increase was 20%. Schlumberger’s representative came up to the head table first—I was watching on the live, Internet webcast. The Pemex official in charge of the proceedings

opened the letter and read the higher commitment was 60%. “They’ve won,” I said to myself. Then the Petrofac country manager came to the table with his envelop: The commitment was 100.5%.

Afterwards, I heard a lot of cynicism about that bidding criterion. “You would have to gold-plate the valves to spend that money,” commented on retired Pemex engineer who was working at the time for **Grupo Diavaz**.

PPI: I’m not familiar with the details of that award, but your story illustrates very nicely how irrational things can get. Spending more money in absolute terms is no guarantee that better results will be obtained. Such a requirement is an insult to the very Pemex engineers who first designed the terms and conditions of the tender. If they thought US\$20 million was sufficient, why ask more? And why accept an offer from someone who offers to invest \$40 million? It makes no business sense.

But you have not yet identified one crucial element of the story. *Why* do you think that the officials in charge of the tender used the criteria of lowest price and percentage increase of capital commitment?

MEI: I would say that their motivation was to bullet-proof the award against any future allegations of favoritism or corruption. As we know, in 2010 and 2011 there were several instances in which Pemex careerists, doing their jobs, were summarily dismissed, and charged with civil and even criminal misconduct, all because auditors got the idea in their heads that certain transactions and certain contracts were not handled the way they imagined.

[PPI]: So, in this light, it’s easy to see how, consciously or otherwise, a Pemex official who is responsible for a public tender will want to make the criteria for an award as simplistic as possible.

MEI: Such attempts to simulate transparency by reducing the criteria for an award to one or two quantitative metrics do not at all follow the guidelines in Constitutional Article 134, which I term the “Government Procurement Article.”

PPI: How so? I’m curious.

MEI: Article 134 specifies that the public interest is served when multiple factors are taken into account in addition to cost, factors such as financing, timing, after-sale support and reputation for quality of the vendor. In this light, it would be improper—not to say “unconstitutional”—to reduce these factors to ones of lowest price or highest capital investment commitment.

PPI: That’s right. I can tell you that we expect the new legal figure of a State Enterprise to protect procurement officials from the threat of prosecution in order that they may fully and creatively discern the best, full-cycle value for Pemex and the country.

MEI: You remind me of a troubling story that I heard recently about the procurement of certain deepwater drilling rigs, of the semi-submersible kind. As we know, rigs are global commodities, and they have to be moved sometimes half-way round the world to reach their new assignment. What I heard is that a certain vendor was awarded a Pemex contract partly on the grounds of his commitment to keep the rigs in Mexican waters.

So far as I understood, the contracts (and there have been at least three) were issued without a public tender, a detail that, seemingly, suggest a violation of Chapter 10 of NAFTA, which deals with

government procurement. But what we find troubling is that the story suggested ad hoc decisions that may have reflected additional considerations that are not in the public domain.

[PPI]: Your story—if it is true or not—depicts a cowboy procurement culture. If it exists in the current system—and I have heard other stories like yours—then we want to get rid of it. We want to substitute a full commitment to full-cycle procurement in which the “cycle” extends beyond a presidential administration, if you catch my point.

MEI: I caught it. It’s a very big challenge. I’m unsure about how “centralized procurement” will work in practice. I understood the part about a centralized list of vendor, and I can see how you can eliminate some costs and time from having a standard, digitalized process—much like renewing your driver’s license or paying your taxes online. This ability to do routine tasks more efficiently, however, doesn’t at all mean that will lead to better decisions regarding the procurement of specific goods and services.

PPI: True.

MEI: There still needs to be someone who approves a given procurement transaction. It’s always been striking to me how well Pemex managers can do a certain kind of dance around procurement, a “Pemex Two-Step.” The manager tells you that he is very interested in having your product or service, but he is constrained by those pesky “acquisition committees,” whose behavior, he insinuates, can be unpredictable and even irrational. In short, the message is that there is little he can actually do in order to purchase your product, as any decision lies elsewhere. Such sales calls typically end on a tone of *Veremos* (Let’s see); but, to himself, the vendor is like to say “Another missed sale in Pemex.”

PPI: I’m very familiar with what you’re talking about.

MEI: Let me give you a specific example. At the reception on January 7th I asked a member of your staff about the possibility that your organization might become a subscriber to our newsletter. The automatic reply was something like this: *“Ah, yes, but such a decision would have to be made in Mexico by the Department of Public Affairs [Comunicación Social].”*

PPI: Thanks for bringing this example up. I shall revisit your suggestion personally.

MEI: Let me add color to my image of a procurement dance. In the mid-1990s, **Valero Energy** was hoping to build an MTBE plant for Pemex Refineries, and had opened a business development office in Mexico City. Valero’s representative, Ted Gayok, who is now long retired in Arizona, had a memorable expression: *“With Pemex, never take ‘yes’ for an answer.”*

PPI: I think I can see where you’re going with this: In Mexico, there is a well-known expression, adapted from a popular song, which goes *“Tell them ‘yes’ but don’t tell them ‘when.’”*

MEI: Yes, exactly. Sometimes the “when” refers to the opportunity to speak with the official who has procurement authority. It can happen that weeks can go by without reaching, by telephone, the person with whom you need to speak. His secretary—miraculously—has a new explanation about why this person is unavailable. Once, in trying to reach someone from the IMP, we made a list of the explanations. After a while, we were laughing about it. I recall some of the items on our list [see insert].

PPI: It’s funny that you should have made that list. You should know, however, that such treatment is not reserved for vendors. You can be a Pemex employee and have a similar experience in relation to matters other than procurement. You also appreciate that in Mexico there is a cultural trait that makes us reluctant to say “no” outright; so sometimes we say “yes” when we mean “no.”

Secretarial barriers to communication

He's' not here	He's in a meeting	He's left for lunch	He just left
He's not yet arrived	He's with the Director	He's on vacation.	He's on another call
He's outside the City.	He's on a temporary assignment	He's with some other people	He's on a trip

Another trait of our business culture that you should keep in mind is that Mexicans—and, in this respect, very unlike Americans and Europeans—prefer not to “talk business” on the telephone. If given the choice, our telephone conversations would be limited to matters of scheduling a meeting, not to matters of substance.

These cultural traits get us crossed up with vendors, as was Mr. Gayok’s situation. You can see that improving the procurement culture of Pemex goes beyond improving paperwork and protocols; it reaches all the way back to certain tendencies in Mexican culture.

MEI: I appreciated your point about not having to do unnecessary market research in order to justify a procurement decision. Let me give a very personal story about that. During the Fox administration my firm was awarded a significant contract from the Office of the Director General of Petróleos Mexicanos. My assignment was to monitor Pemex’s international communications and to make recommendations for improvement.

To obtain this contract I needed to submit a standard proposal stating purpose, background, qualification, cost, etc. To my surprise, someone in the Public Affairs Office whom I had known for quite a few years informed me that an additional two bids would be needed to be in my file. The bids would need to be priced higher than mine, in order to justify the award to me by virtue of the lowest price.

This manager—who, by now, has retired, or so I assume—hinted that if an auditor were to discover that my file lacked the two other bids then it could result in my being disqualified as a vendor in the future. It was a soft warning that I had better do what she said.

PPI: Your story—and I’ll ask you, off-line, how it ended—nicely illustrates the kind of corruption-by-simulation that we want to eliminate from the procurement process.

MEI: There will be a new category of procurement under the new regime in which Pemex will be allowed to seek equity relationships with third parties and offer them farm-in rights in certain blocks, that is, a share of production or profits in exchange for capital and performance. But I gather that such procurement will not take place in the new department in Pemex that you may be called upon to lead.

PPI: That’s true. A different protocol will apply, but at this moment we don’t know any details. What we understand is that Pemex will propose to the Energy Ministry the name or names of proposed companies with which an equity-type relationship is sought. The Ministry will consult with the

Hydrocarbon Commission (CNH) and a recommendation will be sought as to the advisability of such a relationship.

With a green light from the Ministry, Pemex will need the involvement of the Finance Ministry (SHCP) to work out the details of taxes and royalties in a given case.

MEI: It sounds like there's a lot of room for discretionality in such a process. We may suppose that the deliberations will not be subject to public oversight, so, in effect, a new "black box" of decision-making will have been created.

PPI: George, you've been in Mexico long enough to know the higher meanings of the expression *Prefiero no comentar*.

MEI: I have, and I do.

Before we finish, we should speak for a few minutes about the matter of national content and about the future of Pemex. Earlier, I mentioned my idea of a Pemex 2.0. At a conference at the Baker Institute on October 31, I called for a Pemex 2.0 as a majority-owned oil company with unrestricted shares in the New York Stock Exchange. I said that IOCs would feel much better about having a joint equity relationship with a Pemex 2.0 than with Pemex as a government agency.

One concern that I have is about the legal status of Pemex and CFE as a "state enterprise." I'm concerned that the new figure might exempt them from requirements to comply with NAFTA rules of government procurement. I worry that the new figure will be in a grey area of the law: Pemex will not yet become Pemex 2.0, a state, majority-owned oil company; but neither will it remain a decentralized federal agency.

PPI: You are probably correct that a Pemex 2.0 is in the future; but that future is not 2014, nor, I suspect, any year during the remainder of this administration.

MEI: The subject of a national-content requirement is a vexing issue of public policy. If you make the requirement too strict, then you scare away investors or you create a room full of companies who simulate national content—like the drilling company who has the rigs but not the technical crew or in-house experience of how to conduct ultra-deepwater operations. You could say that this company's just having the vessels was in itself national content; but that's not what's meant, as we understand it.

We recall that during the Oil Boom (1978-81) there were Mexican companies that routinely subcontracted their work to foreign companies. An example is PERMARGO, which, for its drilling contract for the well Ixtoc-1, subcontracted with SEDCO, a Texas company that had been founded by then-governor Bill Clements.

In recent memory, it has happened that a Mexican company gets a Pemex contract by virtue of connections, by blood or circumstances, with members of Mexico's 100 Best Families, which include the families of presidents and important cabinet ministers.

PPI: Both things you say are true: we want to promote real national content, and we certainly want to minimize simulations.

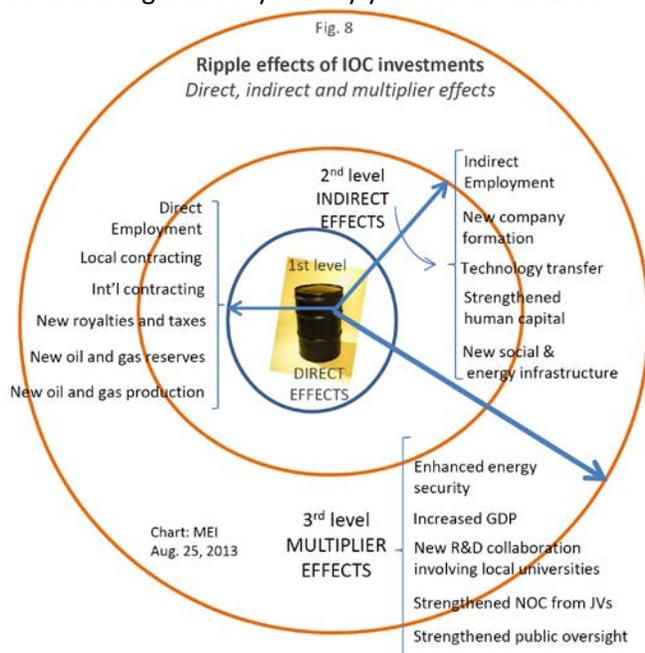
MEI: Some of these simulations come from influence peddling—the “commerce of influence,” as you say in Mexico. In recent memory, we can recall companies that were established overnight without real corporate experience, that have been awarded Pemex contracts.

MEI: I worry that the *apertura*—as Venezuelans used to say—may turn out differently from what was expected at the beginning. I can imagine a scenario in which in Round Zero Pemex is given premium acreage, then finds international companies to be minority equity partners and operators; in this scenario the State will continue to face the paradoxes of public oversight that we have now under the current regime.

This scenario is much like the one that has evolved in natural gas: nearly twenty years after the 1995 liberalization of the sector, today there is no natural gas transportation line that competes with one of Pemex Gas (PGPB). Applying this precedent to the upstream, we can imagine that there would only be Pemex “partners”—Mexican and otherwise—and few, if any, Pemex competitors.

PPI: Yes, such an outcome would not be what the government is expecting. There are a lot of people in Mexico who, today, feel that the privatization of **Telmex** did not go as the government planned; and many of these have similar worries about how the 2013 energy reform may eventually turn out.

MEI: Let me show you a chart that appeared in a recent report that shows three concentric circles of the ripple effects of upstream investment. In the first circle you get direct employments, in the second you get indirect employment. It is in the third circle were things get dicey.



Source 1 How IOCs and Host Countries Create Wealth (No. 10027)

PPI: Interesting chart. I’d like to read the whole report. As I’ve been saying, to straighten out Pemex procurement, and to have the effects that your chart indicates, are very big aspirations.

MEI: Thank you again for making room in your day for this conversation. I hope that we may continue it at a future point when some of the unknowns become public information, and when we have the new procurement processes in which you place so much faith for the future. We shall want to ask you, on a future occasion, if the institutions, centralized database and new protocols that you will develop are meeting your earlier expectations.

PPI: I hope that they do meet my expectations; and I will gladly meet with you again down the road in order to continue this interesting dialogue.

