Houston, July 14, 2015

Market Comment 075

ZERO CNH DISCRETIONALITY

The counter-arguments

GIVEN A SOCIETY THAT HAS BEEN TAUGHT TO DISTRUST any involvement of the companies other than Pemex in the exploration and exploitation of Mexico's petroleum endowment, it is perfectly understandable that the government should want to sugar-coat the upstream reform with justifications, promises and assurances of diverse kinds. Given a political culture in which there is the perpetual suspicion that public wealth is mysteriously channeled into private hands, it is equally understandable why the government should want to represent the auctions that are being conducted by the Hydrocarbon Commission (CNH) as squeaky clean and absolutely transparent.

It's also true that in conducting auctions for petroleum blocks, governments around the world go by the numbers. A bidder is compared to others by virtue of a numerical evaluation. In federal waters in the U.S. Gulf of Mexico, auctions are held in which the sole number is the price that the bidder offers to pay for a lease. In the U.S. system, a bidder has basic requirements to register as a bidder, but his technical qualifications are not evaluated. The winner obtains, on an exclusive basis, the right to ask regulators for permission to drill in his block.

Other jurisdictions (among them Mexico) evaluate the technical qualifications of prospective bidders in order that they may "pre-qualify" in a given auction. An auction is conducted as if the technical attributes of all pre-qualified bidders were of equal merit. Some jurisdictions (among them Colombia and Saudi Arabia) score the work programs and investment commitments, giving each factor a weight. The Peña government has chosen to evaluate only the numbers for the percentage of government's share of production and the total investment commitment.

That said, there is ample room to disagree with Mexican authorities in relation to the substance and law associated with their intended use of the numbers supplied by the bidders in relation to the award of a block. This report offers counter-arguments in regard to denying CNH discretionality in determining the winner of an auction for a petroleum block.

Contents

MEXICO ENERGY INTELLIGENCE® (MEI) is a commercial and policy advisory service offered by BAKER & ASSOCIATES, ENERGY CONSULTANTS, a management consultancy based in Houston. MEI reports facilitate two-way communication between Mexican public and private institutions and the global environment. Our reports examine policy, institutional and cultural issues as they affect the operating environment, energy regulation, and government and private investment in Mexico's energy sector. Reports are distributed principally on a subscription basis.

Reports related to award criteria for upstream contracts

Year	Topic	File #	Pages	Chart

2015

Date	Topic	File #	Pages	Chart
Jun 30, 15	**Injunctive Relief (Amparo) in Mexico: A legal recourse available to obstruct energy policy** This report introduces the legal theory and vocabulary that will be employed in resolving the request for injunctive relief by Mineral del Norte, S.A., in relation to Article 27 of the Hydrocarbon Law. In December 2014, a federal court order the suspension of all activities authorized by this article of the law in the area of the coal concession. One result of this order was the removal of the Anáhuac field from the 3rd cycle of bidding Round One; another effect was to freeze Pemex's plans to convert risk-service contracts of the Olmos, Pirineos and Monclova fields; a third effect was to tarnish the process.	786	6	2
Feb 21, 15	**Ronda Uno vs. LOPSRM (article by George Baker in Reforma)** Published in the opinion page of the Business Section of REFORMA on February 20, 2015, this article by George Baker finds fault with the award criteria in the Draft Model Contract of the Hydrocarbon Commission (CNH) on December 11, 2014. He argues that a bidding variable of the highest government percentage is merely the mathmatical inverse of the variable of lowest price found in the Public Works Law (LOPSRM). Both variants, he argues, are designed to protect public servants against possible sanctions by future auditors than to serve the public interest.	022015	1	0
Jan 15, 15	**Transparency vs. Value Creation: An Inverse Correlation** This report speculates about the relationship between Transparency, Value-Creation and Educational Requirements in Mexican government procurement. Four models are considered: Public Works, Pemex law, Round 1 and Round N. The report concludes that society's demand for transparency is subverted by the need of regulators to protect themselves from auditors whose educational level would not be adequate to understand how an award in a bid round was determined on the basis of its total value compared to the offers of other bidders.	1000060	2	3

Reports related to award criteria for upstream contracts

Year	Topic	File #	Pages	Chart

2014

Dec 12, 14	**CNH's Round One Bidding Guidelines: LOPSRM Reborn** This report provides an inventory of some 50 terms and concepts that are set forth in the CNH's bidding guidelines for 14 shallow-water blocks in the Bay of Campeche. The generation of this specialized lexicon was made possible by an application of our in-house DICTIONARY OF MEXICAN ENERGY. The publication of these guidelines deserves applause in recognition of the diligence of public officials in CNH and the energy and finance ministries. At the same time, the details of the bidding protocols are reminiscent of the old way of doing government procurement in Mexico.	1000056	6	1
Jun 29, 14	**Philosophy of the Biddable Variable** The Hydrocarbon Revenue Act of 2014 requires that the Finance Ministry devise a "single economic variable" that would be used in a given public tender. In this report it is argued that the state should give equal attention to the collateral and cascading effects of a bidder's proposed work program. The logic is seen in an imaginary scoring in a public tender of seven bids for an exploration block (Table 1). Consideration should be given to the policy framework in which such a scoring system would make sense . http://bakerinstitute.org/research/philosophy-biddable-variable-why-bidders-work-program-important/	062914	5	2

2011

Feb 25, 11	**PEMEX Contract Discretionality: An Inconvenient Translation** This report examines the use of *conveniente* and *inconveniente*, words that--despite the obvious English cognates--do not generally translate as "convenient" and "inconvenient." In a recent seminar, many in the audience were disoriented by the provision in the Pemex Specimen Contract of November 24, 2010, that permits Pemex to cancel a contract if a project becomes "inconvenient or unprofitable." The report provides context-sensitive translations for each occurrence of this slippery term.	100081	7	2

(832) 434-3928 (text/cell)

Mailing Address:

Box 271506

Houston TX 77277-1506