

## TRION FARMOUT ANALOGY

*A farmout and the Trion auction are alike in just two respects*

INDUSTRY OBSERVERS and their lawyers who are familiar with farmout agreements in jurisdictions outside Mexico have been puzzled by the government’s use of “farmout” for a contract model that lacks the essential elements of this kind of agreement.

A farmout model presumes that an oil company (the “farmor”) holds a lease, a portion or percentage of which it wishes to convey to another party (the “farmee”) in exchange for certain benefits. The clock on a farmout agreement is quite different from that of other associations in the oil industry: the farmee has to perform certain agreed-upon activities that, together, would constitute the Earning Event, at which future moment a working interest in the lease is conveyed.

The contract model that has been proposed for the Trión lease has two basic features in common with a farmout agreement:

1. There is an initial period during which obligations are placed on the farmee.
2. The farmor is not required to contribute capital during this period.

In the Trión auction, there is the obligation of the farmee to spend US\$464 million in specified activities, during which time Pemex’s capital contribution is “carried” by the partners.

There is an additional common feature but only applicable to agreements on public lands and waters: In the U.S. Gulf of Mexico, the government must approve any transfer of lease interest to

another party. In Mexico, the exploitation of all minerals requires government permission.

A farmout agreement and the Trión contract model differ from each other a dozen other respects (Table 1). For example, it is not that Pemex is *conveying* a portion of its working interest in the lease; it’s that the National Hydrocarbon Commission (CNH) is *proposing* Pemex’s working interest (currently, at 40%).

For both the investor and Pemex, many of these differences add challenges, such as having to triangulate through a third party (CNH) for matters that are normally settled by direct negotiations. Will contract bidders and Pemex be comfortable with these contract uncertainties, or will they count on negotiating contract improvements after the auction is over?

George Baker  
Publisher

### About this report

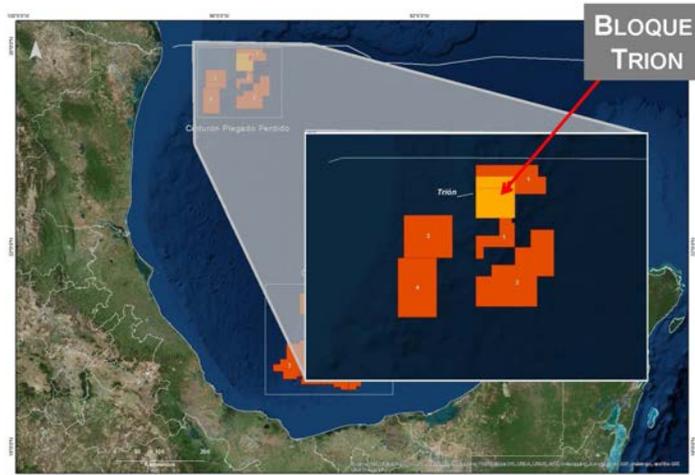
Industry sources in Houston commented on Table 1. Hunt Buckley, in Mexico City, added insight. Sr. Limpiador, in Berkeley, reviewed the table and text.

|   | Farmout Agreement     | Trion Farmout Analogy | Notes  |
|---|-----------------------|-----------------------|--|
| <b>INITIAL PERIOD</b>                                 | <b>Earning period</b> | <b>Carry Period</b>   |  |
| Original leaseholder                                  | Farmor                | Pemex                 | Previously leased to Pemex in Round 0, but returned to the State |
| Obligated to contribute capital during initial period | No                    | No                    |  |
| Conveys a working interest to a second party (farmee) | Yes                   | No                    | CNH establishes the working interests                            |



## Additional reading

### MIGRACIÓN DE ASIGNACIONES A CEE BLOQUE TRION – LOCALIZACIÓN



| Year | Topic | File # | Pages | Chart |
|------|-------|--------|-------|-------|
|      |       | 2      |       |       |

## 2016

|   |  |         |    |   |
|---|--|---------|----|---|
| Aug 24, 16  | <b>Trión Auction: Problematic Issues</b>                           | 816     | 11 | 0 |
| <p>This report draws on our critiques of the government's bidding protocols for the three auctions of Round 1 held in 2015. The report identifies risks for the several stakeholders in the Trión auction: the government, Pemex and prospective bidders. In the second part of the discussion, we offer ideas for how to improve the process of partner selection.</p>   |  |         |    |   |
| Jul 19, 16  | <b>De las formas paralelas: ¿Trión y Fénix?</b>                    | 071916  | 1  |   |
| <p>This column asks, skeptically, about the likelihood that the many tasks associated with a lease auction can be carried out of two blocks of Pemex in the Perdido area in time for the auction of deep water blocks in CNH Round 1.4. Ten days later, CNH published its auction schedule for Pemex's leases in the Trión areas to coincide with the date for the auction of the government's blocks (Dec. 5, 2016). The role of Lourdes Melgar in promoting synergy between Pemex and other oil companies is mentioned. Published in MILENIO "La Energía de Baker."</p> |  |         |    |   |
| Jun 13, 16  | <b>Trión 101: Pemex proposes fast-track for deep water auction</b> | 1000083 | 8  | 2 |
| <p>This report draws on industry courses for an initial impression of Pemex's last-minute proposal to include the Trión block in an auction to be scheduled in parallel with Round 1.4. Three potential commercial arrangements are considered: 1) Farmout, 2) Standard Production Sharing Agreement (PSA) and 3) Carried PSA. In order to allow sufficient time for the bid round to be organized and for prospective bidders to have access to a data room, Block 1 of Round 1.4 should be rescheduled at an appropriated time in 2017.</p>                             |  |         |    |   |



## Additional reading

| Year | Topic | File # | Pages | Chart |
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|------------|--|-------|---|---|
| Jun 07, 16 | <b>Paths to Pemex Partnership: Farmout, Cash Sale and Carried Interest</b> | 10037 | 6 | 1 |
|------------|--|-------|---|---|

This report identifies three contract models that could serve in partnerships between IOCs and Pemex in Pemex blocks: 1) Farmout, 2) Standard Production Sharing Agreement (PSA), 3) Carried Interest PSA. Table 1 provides a list of the advantages and disadvantages of each model from the perspective of the original lessor. The report calls attention to the need for an auction round of Pemex blocks in the Perdido Area to complement the blocks offered by the government in Round 1.4. A video from 2008 on Pemex's challenges in deep water areas is instructive: <http://bit.ly/1WIM3WI>.

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## 2015

|            |   |       |    |   |
|------------|---|-------|----|---|
| Dec 29, 15 | <b>Pemex's Farmout Strategy: International Expectations</b> | 10036 | 13 | 3 |
|------------|---|-------|----|---|

As far back as July 2014--three weeks before the promulgation of the energy reform legislation--Pemex told Reuters about its plans for farmouts, using a term that had scarcely been heard before in Mexico. During the following 15 months Pemex identified blocks that would be candidates for farmouts. Together, these blocks covered some 525,000 acres with an expected investment of some \$50 billion. This report is an examination of the nature of a farmout agreement, its core concepts and terms. In a separate report, we shall examine the legal issues to be resolved before a farmout agreement can be signed.

|            |   |     |   |   |
|------------|---|-----|---|---|
| May 18, 15 | <b>The Farmout Opportunity in Mexico: The Pillar of Pemex's Frontier Strategy</b> | 783 | 8 | 3 |
|------------|---|-----|---|---|

Until Sept. 13, 2014, the oil industry term "farmout" was all but unknown in Mexico. On that date, in a briefing at the Energy Ministry, it was revealed that 4/5ths of the properties for which Pemex had received permits for exploration and extraction would continue to be under Pemex's operatorship; some of these properties, however, were labeled as "farmouts." Those properties included mature fields as well as frontier plays in heavy oil, deepwater gas and deepwater oil. This report examines the nature of a farmout agreement as understood outside Mexico. Pemex's negotiating options are presented.

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