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FEATURED Q&A

How Is Mexico's Round One Oil Auction Shaping Up?

Q Mexico's government in December unveiled the terms of production-sharing contracts for 14 shallow-water exploration and production blocks and issued a call for bids as part of the first phase of Round One, the country's first public bid auction since it opened up its oil and gas sector to foreign and private investment. In total, Round One will include 169 blocks, with contracts expected to be awarded later this year. How is Mexico's Round One shaping up? Are investors interested in the areas on offer and the terms provided? Will lower oil prices or other headwinds dampen investor enthusiasm?

A Larry B. Pascal, chair of the Americas Practice Group at Haynes & Boone in Houston and William "Hunt" Buckley, partner at the firm in Mexico City: "As part of the implementation of the energy reform, the Mexican government has selected certain areas and fields out of Round One that will be tendered for private-industry participation in hydrocarbon exploration and production projects. Round One comprises 109 blocks for exploration and 60 blocks for production and includes new areas of different sizes and types of resources, including deep-water, shallow-water and onshore fields. Together, these blocks cover approximately 28,500 square kilometers and represent an annual investment of approximately $8.5 billion. More specifically, on Dec. 11, the National Hydrocarbons Commission (CNH) published in the National Federal Gazette the first call for an international public bid to award exploration and production agreements for 14 shallow-water contract areas offshore Campeche, Tabasco, and Veracruz. This first call does not include all of the blocks covered by Round One. The total area for this first bid call is 4,222 square kilometers. The prospective resources of the contract areas are estimated to be approximately 686.6 million barrels of crude oil. The production-sharing con-

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Obama Seeking $1 Billion in New Aid for Central America

U.S. President Barack Obama is requesting $1 billion in new aid to help strengthen economies, public institutions and security in Central American countries. The initiative is part of a broader effort to address the child migration crisis. See story on page 2.

File Photo: White House.

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NEWS BRIEFS

At Least Three Killed in Blast at Mexico Children's Hospital

A gas explosion Thursday rattled a maternity and children's hospital in Mexico City, killing two infants and a nurse, injuring dozens more and destroying more than three-fourths of the building, authorities said, the Associated Press reported. A tanker truck delivering propane gas to the kitchen area had a leak in the hose. Workers noticed and alerted the fire department, but the building exploded before it could be contained.

Protesters March in Panama Following Martinelli Graft Claims

Hundreds of people took to the streets of Panama City on Thursday calling for an end to impunity laws and shouting slogans against embattled former President Ricardo Martinelli, *La Prensa* reported. The march, which included the brother of current President Juan Carlos Varela, came a day after the country's Supreme Court allowed an embezzlement complaint against the former conservative president to proceed, saying it would appoint a special prosecutor to investigate claims that Martinelli had inflated contract prices during his term in office, which ended last year.

DR Has Paid Off Nearly $4.1 Bn of Oil Debt to Venezuela: Official

The Dominican Republic's finance minister, Simón Lizardo, on Thursday said the government has paid off nearly all of a $4.1 billion oil debt to Venezuela it has accumulated since 2005 under the Petrocaribe program, *Dominican Today* reported. The Caribbean nation used funds raised through a bond sale last week, spending $1.93 billion to pay off 98 percent of its debt to Venezuela at a discount.

Political News

Obama Seeking $1 Billion in New Aid for Central America

The White House announced Thursday that President Barack Obama will request $1 billion in new aid to Central America as part of his Fiscal Year 2016 budget. The money, part of a plan being hammered out in recent months to address a child migration crisis that came to a head last year, will be targeted to economic integration, public safety and more effective governance, the White House said. About 40 percent of the aid will go to "prosperity and regional integration" initiatives aimed at trade facilitation, energy and jobs. Vice President Joe Biden had traveled to Guatemala near the peak of the child migration crisis last June, when some 60,000 unaccompanied minors were reported to have appeared in the United States within about a year seeking protection. In an editorial Thursday in *The New York Times*, Biden compared the new Central America aid to the United States' investment in Plan Colombia last decade. "The United States invested $9 billion over the course of Plan Colombia, with $700 million the first year. But our figures show that Colombia outspent us four to one," Biden said in the editorial. "The cost of investing now in a secure and prosperous Central America is modest compared with the costs of letting violence and poverty fester." Last November, Central American leaders announced their own Alliance for Prosperity Strategy that commits resources to education, tax regulation and better business regulations. Guatemalan President Otto Pérez Molina has said he and his counterparts from Honduras and El Salvador were prepared to commit $5 billion over 5 years to the plan, a significant sum compared to those nations' gross domestic product. [Editor's note: See related Q&A in the Dec. 19 issue of the *Advisor*.]

About 40 percent of the aid will go to initiatives aimed at trade facilitation, energy and jobs.

Economic News

Peru Cuts Growth Forecast as Central Bank Eyes Rate Cut

Peruvian Finance Minister Alonso Segura said Thursday that the South American nation's economy is likely to grow about 4.8 percent this year, a lower estimate than the December forecast, which predicted gross domestic product growth of between 5 and 5.5 percent, Reuters reported. For 2014, Segura added that the economy likely grew approximately 2.4 percent. The government's stimulus packages, which include tax cuts and spending increases announced over the past few months, were equivalent to about 1.4 percent of the country's gross domestic product, Segura said. Although the forecast is a reduction from December, "Peru will be among the fastest growing economies in Latin America," he added.

Segura

File Photo: Peruvian Government.

A higher level of spending will increase the government's budget deficit to 2 percent of GDP, he said. Also on Thursday, Peru's central bank chief, Julio Velarde, said policymakers have enough room to cut interest rates, Bloomberg News reported. The central bank has already cut rates four times since 2013. If forecasts for slowing inflation prove correct, the central bank could loosen monetary policy "though not that much because consumption remains vigorous," Velarde said in Lima. Two weeks ago, the central bank lowered Peru's benchmark interest rate by 25 basis points to 3.25 percent, and the government said the country's economy experienced its slowest monthly growth for November since 2009. The rate cut

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was a surprise to all 18 economists in a Bloomberg survey. The economists had expected the bank to hold off on easing monetary policy until later this year due to the recent decline in Peru's currency. At Thursday's close, the sol fell 0.4 percent against the dollar, to 3.044 per greenback, the Peruvian currency's weakest level since 2009. Velarde said the sol has probably seen too much weakening, adding that its "fundamental value" was between 2.94 and 3 soles to the dollar. "There may have been an overreaction in the market," said Velarde, Bloomberg News reported. "We talk to central bankers and all of them think there has been an overreaction" in their currencies.

Company News

Telecom Italia to Invest 'Much More' In Brazil: Chief Executive Officer

Telecom Italia is planning to invest "much more" this year in Brazil, Chief Executive Officer Marco Patuano said Thursday after meeting with Brazil's communications minister, Bloomberg News reported. The Milan-based company owns Brazilian wireless carrier **TIM Participações**. "Our plan is to bet on the growth of the Brazilian market," said Patuano. "We're saying in the next few years we're going to have a different level of investment. We're going to invest more in the mobile 3G and 4G networks. We're going to invest significantly more than in 2014, 2013." Mobile carriers have recently been looking to consolidate their operations in Brazil amid a higher level of competition and little growth in the number of users.

> "Our plan is to bet on the growth of the Brazilian market."
>
> — *Marco Patuano*

Featured Q&A

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tracts will have terms of 25 years. To date, the bidding is in the early stages of a process that is scheduled to be completed by August, and hence there is still ample time for further developments that could affect the process. One positive is that the properties are in areas where Pemex has in general explored, where the Mexican oil industry is well-established, and the offshore nature may mitigate security concerns to some degree. Our view is the short-term price fluctuations are not at this stage the most important factor in the bid round. Rather, industry response to the new production-sharing contract, the relative novelty of the process and the role and the adequacy of the resources of CNH to administer the contracts will be important issues as well. Finally, CNH will need to maintain an economically competitive regime, relative to other non-Mexican opportunities, including the United States itself."

A John D. Padilla, managing director of IPD Latin America: "Mexico's Dec. 11 call for bids generally disappointed potential participants. Sector players had expected that the nearly one-month delay in releasing pre-qualification criteria would mean increased flexibility and more market-friendly terms, particularly in light of falling oil prices. But they received the opposite: restrictions on the number of blocks any single company can bid on (five of the 14 on offer); a limit of forming only one consortium for bid purposes; a prohibition on companies that produce more than 1.6 MMBOE from teaming up with one another; and Byzantine-style procurement procedures. Mexican companies, whose support for the energy reform is critical, are among those most affected by these restrictions. The plan to release minimum government take requirements just before bids are due will be a non-starter for numerous operating companies for a variety of reasons. Mexico's long-anticipated opening, prospectivity, varied resource plays, proximity to the world's largest consuming market and history of contract sanctity continue to captivate the international audience. But if, for starters, its commercial terms substantially limit the potential upside, industry participants may look elsewhere. The country's prequalification criteria restrictions won't help, nor will the uncertainty it creates for other area types such as deep-water. Lower oil prices will make potential bidders even more discerning about where they deploy their capital in 2015. If Mexico wants to secure multiple competitive bids—as it should for this historic opening—it will need to revisit both the commercial terms and other criteria it ultimately includes in the bid round."

A David Shields, independent energy consultant based in Mexico City and editor of *Energía a Debate*: "There is no lack of investor interest in Round One. This should be clear to anyone who is on the ground in Mexico or who has been attending promotional events with Mexican government participation. The acreage on offer is exciting, above all because of its geographic location in the Gulf of Mexico. Regarding the terms of the auction, I'm sure nobody would have complained with oil at $100 a barrel, but the collapse in oil prices must be giving most players second thoughts about getting involved. One wonders, indeed, if this can be profitable for anyone. The Round One auctions this year are slated to come in five groups, by oil field type: shallow-water, extra-heavy crude, mature fields, unconventional (shale) and deepwater. My guess is that only two of the five—shallow-water and mature fields—might be profitable at $45-a-barrel oil. However, bidders will have the last word on this. In turn, energy authorities will have to decide whether to move ahead with all five auctions and evaluate whether the bids make economic sense. For now, the shallow-water tender is

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Featured Q&A

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moving ahead, and companies are paying the steep price being asked ($390,000 each) for the right to access the data room and to participate. Time will tell whether bids are forthcoming and accepted. Perhaps Mexico would do well to think that, even if the upstream cannot be profitable and successful right now, other energy reform priorities could well be: electricity-market reform, pipelines, refining, clean energy and sustainability."

A Jeremy M. Martin, director of the energy program at the Institute of the Americas: "There is a silly commercial that has a character called Captain Obvious, who would state that Mexico's Round One has a long shadow cast over it by slumping oil prices. Indeed, Mexico has done much to get to this historic point only to be slammed by low oil prices. Of course, issues surrounding transparency and impunity have also returned to the fore in Mexico and undermined much of the Peña Nieto government's economics-first platform. It would be unwise to underestimate how poorly these stories are received in oil company headquarters across the globe. But beyond the three-headed bogeyman of low oil prices, security concerns and rule of law issues, there are questions over the restrictions that have been put in place for the shallow-water tender. Limitations on how many blocks and with whom companies can partner have raised some eyebrows. In the case of the shallow-water blocks, the restrictions may not greatly deter interest, but they have raised concerns vis-à-vis future offerings. There are, however, three silver linings for Mexico. The first is the long list of companies that have waited years for the opportunity to bid on a project and have taken a long-term view on the market. The second may be a bit more esoteric: companies want to have a seat at the table, and they may not wish to miss their first opportunity. The third brings us back to where we started: price. Mexico was savvy to start with the shallow-water tender, an area where there is ample data, experience, and most critically, lower cost and risk."

> "Limitations on how many blocks and with whom companies can partner have raised some eyebrows."
>
> *— Jeremy M. Martin*

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