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September 3, 2021

Dirección General de Consultoría Jurídica de Comercio Internacional  
Secretaría de Economía  
Pachuca #189, piso 19  
Col. Condesa  
Demarcación Territorial Cuauhtémoc  
Ciudad de México  
C.P. 06140

**Re: Notice of Intent Under Chapter 14 of the United States-Mexico-Canada Agreement**

Dear Sir or Madam:

1. Pursuant to Articles 14.D.3(2) and 14.E.1 of the United States-Mexico-Canada Agreement (“USMCA”), and with a view toward resolving this dispute amicably through consultations, Talos Energy, Inc. (“**Talos**”) hereby gives written notice of intent to submit a claim to arbitration on its own behalf and on behalf of Talos Energy Offshore Mexico 7, S de R.L. de C.V. (“**Talos Mexico**”)—a Mexican enterprise that Talos owns and controls—for breach by the United Mexican States (“**Mexico**”) of its obligations under USMCA Chapter 14.

**I. Name and Address of the Disputing Investor**

2. Talos is a Delaware corporation in the United States of America with its headquarters in Houston, Texas. Talos is an Investor of a Party to the USMCA pursuant to Article 14.1 of the USMCA.

3. Talos' business address is as follows:

Talos Energy, Inc.  
333 Clay St., Suite 3300  
Houston, TX 77002  
Tel: +1 713 328-3000  
Fax: +1 713 351-4100

4. Talos Mexico is a Mexican enterprise that Talos owns or controls. Talos Mexico's business address is:

Talos Energy Offshore México 7  
Andrés Bello No. 10, Piso 11  
Col. Chapultepec Polanco  
1150 Ciudad de México  
Tel: +52-55-1328-9270

5. King & Spalding LLP is Talos' counsel in this matter.<sup>1</sup> All communications submitted in relation to this notice should be sent to the attention of R. Doak Bishop and Fernando Rodriguez-Cortina at the following address:

King & Spalding LLP  
1100 Louisiana Street  
Suite 4100  
Houston, TX 77002

[dbishop@kslaw.com](mailto:dbishop@kslaw.com)  
[frrodriguez-cortina@kslaw.com](mailto:frrodriguez-cortina@kslaw.com)

6. Talos Mexico, together with its consortium partners Wintershall DEA (originally Sierra O&G Exploración y Producción, S. de R.L. de C.V.) and Premier Oil Exploration and Production Mexico, S.A. de C.V. (collectively, the "**Contractor**") entered into a Contract for the Exploration and Extraction of Hydrocarbons Under Production Sharing Modality with Mexico on September 4, 2015, granting Talos rights in Block 7 with respect to the exploration and extraction of oil (the "**Contract**"). Talos Mexico, the Contract, and the investments that Talos has made in Mexico through its ownership in Talos Mexico (some of which are described in Section II below) constitute investments under Article 14.1 of the USMCA.

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<sup>1</sup> Power of attorney is attached as Annex 1

## **II. USMCA Provisions that Mexico Has Breached**

7. Mexico has breached its obligations under the following USMCA provisions:
  - a. Article 14.6: Minimum Standard of Treatment; and
  - b. Article 14.4: National Treatment

## **III. Factual and Legal Basis for the Claim**

### **A. Factual Background**

8. After nationalizing its oil industry in 1938, Mexico once again opened its oil and gas resources to private investors in 2013. In 2015, it held its inaugural bidding round for development blocks. The bidding process for Block 7, located in the Gulf of Mexico, was intensively competitive and eventually won by Talos and its Consortium partners. As a result, Mexico awarded them Block 7 and entered into the Contract with Talos as the Operator and Talos' Consortium partners.

9. Soon after the execution of the Contract, the Contractor led by Talos drilled four wells, three horizontal and a sidetrack, *i.e.*, a secondary well drilled from a pre-existing well in order to reach a new location in the target area, in 160 meters of water on Block 7 at a cost of approximately USD \$350 million, of which Talos contributed over \$122 million, resulting in the large-to-super giant Zama discovery in 2017. Zama, a Miocene-aged sandstone reservoir, holds recoverable oil in the range of 500-800 million barrels, possibly more than a billion. Due to Talos' substantial investment and technical expertise, the discovery and appraisal program of Zama was completed ahead of schedule and at a cost approximately 25% below budget.

10. While Talos expended significant time and resources in discovering and developing Zama, Pemex made practically no investment of its own. Despite publicly announcing its intention to drill a well to penetrate the shared reservoir in February 2018, and despite CNH's later recommendation that Pemex drill such a well, Pemex never did so. Instead, in a recent public hearing before the National Commission of Hydrocarbons ("CNH") Board of Commissioners, Pemex removed the well from its exploration plan entirely, despite some of the Commissioners' express recommendation that Pemex drill the well.

11. Talos' successful appraisal revealed that Zama extended across the boundaries of the Contract Area and into AE-0152-Uchukil Assignment, a block held by Pemex Exploración y

Producción (“**PEP**”), a subsidiary of Petróleos Mexicanos (“**Pemex**”). Pursuant to Section 9.1 of the Contract, on October 5, 2017, Talos therefore submitted a “Notice of Possible Shared Reservoir” to the CNH. To expedite development of the Zama field, on December 9, 2019, Talos also submitted to Mexico’s Secretaría de Energía (“**SENER**”) a “Notice of Possible Shared Reservoir” pursuant to Articles 11 and 13 of the Unitization Guidelines, the protocol establishing the procedure for unitization of shared reservoirs and approving the terms and conditions of unitization agreements (“**Unitization Guidelines**”). This notice was exclusively based on information provided by Talos due to PEP’s failure to drill any exploratory wells.

12. On May 7, 2020, CNH issued a technical opinion confirming the existence of the shared reservoir. Around the same time, Netherland Sewell, a highly regarded reservoir analysis company, determined in a Talos-commissioned report that Block 7 held 60% of the field’s reserves and PEP’s block contained 40% of the reserves.

13. On July 7, 2020, by means of Official Letter No. 500.SSH.26/20, SENER found that there is a Shared Reservoir encompassing portions of Block 7 and Assignment AE-0152-Uchukil (the “**Zama Unit**”), and instructed its unitization, requiring PEP and the Contractor to submit their proposal for a Unitization Agreement and Unit Operating Agreement (the “**Unitization Agreement**”) within a period of no more than one hundred and twenty (120) business days, pursuant to Articles 21, 22, and 24 of the Unitization Guidelines (the “**Unitization Instruction**”).

14. Following the discovery of the shared reservoir, the Contractor had made extensive and persistent efforts to negotiate with PEP the terms and conditions of a Unitization and Unit Operating Agreement (“**UUOA**”), even entering into a Pre-Unitization Agreement (“**PUA**”) with PEP in 2018 to facilitate negotiations. Despite the Contractor’s significant efforts to move things forward, PEP made only minimal efforts to negotiate a UUOA. This continued even after SENER’s Unitization Instruction, frustrating Talos’ efforts to negotiate the UUOA, and eventually forcing the Contractor and PEP to ask SENER to extend the 120-day deadline to reach an agreement. SENER granted a 60-day extension, but PEP remained disengaged, thereby guaranteeing that SENER would have to set the terms and conditions for the Unitization Agreement. So on March 26, 2021, SENER informed the Parties that it would decide on the terms

and conditions of the Unitization Agreement within a year as required by Article 27 of the Unitization Guidelines.

15. Per SENER's request, on June 14, 2021, the Contractor and PEP submitted to SENER a reserve allocation report that the parties had instructed Ryder Scott to prepare. Ryder Scott opined that 50.4% of the reservoir was in PEP's block and 49.6% of the reservoir in the Contractor's. This was in sharp contrast to the 40/60 split found by Netherland Sewell. Tellingly, while both Pemex and SENER were aware of the Netherland Sewell report, they never requested it from Talos.

16. As Talos made SENER aware on June 15, 2021, Ryder Scott's report failed to follow the agreed technical procedures, and it relied on technical assumptions that are inconsistent with Industry Best Practices. Further, Ryder Scott's results were inconsistent with the information obtained from the four wells drilled by Talos in the Contract Area.

17. On June 22, 2021, the Contractor requested a meeting with SENER, seeking to understand the next steps that SENER was planning to take in the process of deciding on the UUOA terms. SENER ignored this request and as a result, no meeting took place. Instead, on July 2, 2021, SENER issued a 1½ page decision appointing PEP as the sole operator of Zama (the "**Operatorship Decision**") without prior notice to Talos and without providing Talos any opportunity to provide any comment on the reasons why Talos should be appointed as operator. It did, however, consider secret comments made by both CNH and Pemex, which were not made known to Talos.

18. The Operatorship Decision appears to have been based on two documents. The first is a June 11, 2021 CNH report concluding that "PEP had favorable technical conditions and of execution that guarantee the development of Zama in the short term in conditions of technical feasibility." This is the only content of the report mentioned in the Operatorship Decision. Notably, this report was produced by the head of CNH's Technical Unit and did not follow CNH's standard procedure of submitting such opinions to CNH's Board of Commissioners, whose deliberations are open to the public. Instead, the report was produced out of the public eye. Talos only learned of this report's existence from the Operatorship Decision itself—neither SENER nor CNH made Talos aware of the CNH report prior to issuing the Operatorship Decision, nor was Talos provided an opportunity to comment on or participate in the development of the report. In fact, to this day,

Talos has not seen or been provided a copy of the report despite the role it apparently played in the Operatorship Decision.

19. Likely, SENER does not want to reveal this report as it will evidence that CNH's conclusion that PEP is qualified to operate Zama was formed on the basis of criteria designed to favor PEP and discriminate against Talos. The only clue as to the contents of the CNH report comes from press reports indicating that CNH considered 20 factors in assessing Talos' and PEP's operating capability, three of which factors were specifically designed to bias the decision in favor of PEP and disqualify Talos.<sup>2</sup> These were: (i) more than 10,000 bpd of production in Mexico; (ii) installed transportation and commercialization capacity in Mexico; and (iii) projects developed in Mexico. Not only are these geographic criteria irrelevant to the successful operatorship of an offshore oil field, they also plainly discriminate against Talos and other international oil companies.

20. The second document SENER relied on was a similarly non-public letter from Pemex dated June 29, 2021, whereby Pemex apparently stated that it had the financial capability to develop Zama. In making this claim, Pemex apparently relied on the fact that the Ministry of Finance extraordinarily assigned it part of the 2021 Federal Budget. But having the financial capability to operate Zama in 2021 is irrelevant since Zama's development will require significant and ongoing capital commitments from all parties over the next decade and Pemex does not have access to the capital necessary to develop Zama beyond 2021.<sup>3</sup> Earlier this year Pemex reported that its debt had reached \$113.2 billion at the end of 2020 in spite of several capital injections from the government to boost its weak finances.<sup>4</sup> In fact, Pemex's lack of capital in the long term and its inability to pay key service providers is so widely documented that Moody's recently cut Pemex's credit rating to below investment grade. Pemex's claim of financial capability is incongruous with Pemex's evidently precarious financial situation, yet SENER apparently accepted it at face value without engaging in any serious analysis of its credibility and without recognizing that similar future government funding, and thus Pemex's financial capability to fully

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<sup>2</sup> <https://expansion.mx/empresas/2021/07/09/pemex-zama-talos-factores-sener-operacion>.

<sup>3</sup> <https://www.bloomberg.com/news/articles/2021-08-12/pemex-can-t-afford-to-develop-the-oil-field-it-fought-to-control>.

<sup>4</sup> <https://www.reuters.com/article/us-mexico-pemex/mexico-to-absorb-pemex-debt-payments-in-latest-round-of-help-idUSKBN2BA2H9>.

develop Zama, is in no way guaranteed.<sup>5</sup> Talos still has not seen or been provided a copy of Pemex's letter to SENER, and was neither made aware of it before the Operatorship Decision was made, nor provided an opportunity to comment on it.

21. Talos is objectively the only choice for operator. Talos has proven its technical expertise and capacity by discovering the Zama reservoir and operating Block 7 effectively and efficiently, finishing its drilling program ahead of schedule and 25% under budget. With 148 facilities in the U.S. Gulf of Mexico under its operatorship, Talos has extensive experience operating fields of the same age, rock type, and water depth (160 meters) as Zama. Moreover, Talos has set multiple records for offshore Mexico in its whole coring operations and has already accomplished a four well discovery and appraisal program of Zama. PEP, by contrast, has never produced oil on a continuous basis from wells located in more than 115 meters of water, and its recent experience with the Mulach field, a Miocene-aged sandstone reservoir that is only 5% the size of Zama, demonstrates that PEP has significant difficulties in developing reservoirs of this nature. Due to PEP's lack of appraisal drilling and lack of an adequate development plan, Mulach has experienced a decline in production of 50% in the past six months. Additionally, Pemex's strained finances have impacted its ability to conduct necessary maintenance of its assets, leading to multiple fires being reported in Pemex refineries and terminals in the last seven months, in addition to the fire reported in the underwater pipeline of one of Pemex's satellite platforms at the Ku oilfield *the same day that SENER named PEP operator*. A second fire occurred at the Ku field on August 22, leaving at least five workers injured and one dead. As such, all interested parties—Pemex, Talos, and the Mexican Government—stand to suffer considerable losses under PEP's operatorship of Zama.

22. In stark contrast to Talos' already accomplished four-well discovery and appraisal program, PEP has drilled zero wells in Zama and recently removed its only planned well from its exploration plan. Whether this was due to a lack of funding or a lack of experience in dealing with this type of oil field, PEP's failure to expend any effort to develop Zama is a clear indication of its inability to operate Zama effectively. Given PEP's lack of commitment to drilling an appraisal well in Zama, Zama is likely to suffer a similar fate to the Mulach field. There can thus be no doubt

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<sup>5</sup> <https://www.jornada.com.mx/notas/2021/07/21/economia/ingresos-de-pemex-superan-por-primera-vez-en-cinco-anos-su-aporte-tributario/>.

that Talos is better qualified than PEP to operate Zama and that SENER's decision to appoint PEP was motivated by different, unstated reasons.

23. Overall, SENER's issuance of the Operatorship Decision was inconsistent with its obligations under Mexican law. Article 15 of the Mexican Federal Law on Administrative Procedure requires that SENER act in accordance with the principles of economy, efficiency, legality, publicity, and good faith when undertaking administrative acts such as the issuance of unitization procedure. With regard to the unitization process specifically, Article 27 of the Unitization Guidelines requires that SENER consider the principles of economy, efficiency, competitiveness, legality, transparency, best industry practices and the best use of hydrocarbons in making its decision. Article 15 of the Hydrocarbons Law further mandates that the operator have the technical and financial capability to undertake activities in the contractual area. And finally, the Operatorship Decision must be consistent with the legal standards applicable to administrative decisions under Mexican law, meaning it must at a minimum: (i) not depart from the legal framework; (ii) benefit the public interest and general welfare; and (iii) be in accordance with the principles of reasonableness, proportionality, non-discrimination, and good faith.

24. The facts described above make it clear that the obscure process by which SENER issued the Operatorship Decision in no way complied with Mexican law. SENER awarded operatorship to a company that lacks the technical experience to operate Zama, having never produced oil on a continuous basis from similar deep-water, Miocene-aged sandstone reservoirs. It flatly ignored the principle of economy and the requirement that the operator have the financial capacity to operate Zama given that Pemex's financial situation is so precarious that it cannot even effectively operate the oil fields over which it already has operatorship and its credit rating recently reached junk status. Rather than being transparent, SENER's decision-making was entirely opaque. It relied on a CNH document produced in contravention of CNH's standard, public process for providing opinions, failed to make public the documents on which its decision was based, failed to provide any information to Talos or an opportunity for Talos to comment on the process or criteria by which it would make its determination, and failed to explain how its decision was consistent with the above guiding principles. SENER ignored the principles of due process and good faith, issuing a pretextual decision that lacked adequate reasons and was in fact more concerned with politics than with operator qualifications. This is clear from the fact that while SENER's decision failed to comply with Mexican law, it was squarely in line with the



Government's stated goal of recovering control over Mexico's oil industry that Mexico supposedly lost with the 2013 energy reforms, and of returning Pemex to its place of primacy in the industry.<sup>6</sup>

25. And SENER's selection of PEP as operator is not the only issue with the Operatorship Decision. In addition to appointing PEP as operator, the Operatorship Decision also instructed PEP to submit a proposed Development Plan within 30 days. This is inconsistent with Industry Best Practices and the Unification Guidelines, which require that development plans be issued following a process involving all interested parties and according to process terms set out in the Unification Agreement. All parties must agree on the Development Plan through that contractually defined process in order for it to be approved. However, because SENER has yet to issue the remaining terms and conditions of the Unification Agreement, no contractual framework pursuant to which a development plan can be created has been established. This has allowed PEP to unilaterally propose a development plan to SENER that (i) is designed to benefit PEP without considering Talos' specific obligations and circumstances, and (ii) contains significant technical deficiencies that compromise the viability of the project. This is further evidence that SENER's approach to the Unification Agreement is biased to favor PEP and prejudice Talos, regardless of the consequences for Zama.

26. Given these developments and the lack of clarification from SENER regarding the remaining terms and conditions of the Unitization Agreement, on July 7, 2021 the Contractor renewed its request for a meeting with SENER. On July 28, 2021, Talos sent an additional letter to SENER asking it to reconsider the Operatorship Decision. As of this date, SENER still has not responded to that letter or agreed to a meeting or provided Talos with any further information on the unitization process.

## **B. Legal Basis**

### **i. Mexico failed to provide Talos fair and equitable treatment**

27. Article 14.6(1) of the USMCA requires that each Party accord investors and covered investments fair and equitable treatment in accordance with the minimum standard of

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<sup>6</sup> President Lopez-Obrador issued a document to government officials in July 2020 explicitly stating that this was the administration's goal. See <https://www.bloomberg.com/news/articles/2020-08-04/amlo-lays-out-roadmap-that-weighs-nixing-mexico-s-energy-opening>.

treatment under customary international law.<sup>7</sup> Under the minimum standard of treatment, Mexico's conduct violates the fair and equitable treatment standard if, *inter alia*, it is (1) arbitrary, (2) is lacking in due process, (3) lacks reasons, or (4) is unfair or discriminatory.<sup>8</sup> A decision is considered arbitrary if it is not based on legal standards but on an excess of discretion or is taken for reasons that are different from those put forward by the decision maker.<sup>9</sup> Additionally, the obligation to provide fair and equitable treatment includes the obligation not to deny due process. A lack of due process in administrative proceedings can occur when the administration disregards the fundamental principles upon which the regulatory framework is based, fails to provide any reasons for its decisions, or shows a lack of candor or good faith in its dealings with the investor.<sup>10</sup>

28. Based on this standard, Mexico, by and through the actions of its agencies and instrumentalities described above, has breached its obligations under Article 14.6 USMCA to provide Talos fair and equitable treatment.

**ii. Mexico denied Talos national treatment under Article 14.4**

29. Under Article 14.4 of the USMCA, Mexico "shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments in its territory." Discriminatory treatment does not need to be based on the nationality of the investor in order to constitute a violation of Article 14.4.<sup>11</sup> It is sufficient that a foreign investor be shown less favorable treatment than a comparable Mexican investor.

30. Talos has received less favorable treatment than PEP, and Mexico's conduct has been discriminatory.

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<sup>7</sup> Talos may bring a claim for breach of FET because it is a party to a covered government contract pursuant to Annex 14-E.2.

<sup>8</sup> See *Glamis Gold, Ltd. v. United States of America*, NAFTA Chapter Eleven, UNCITRAL, Award, 8 June 2009, ¶ 627; *Waste Management v. Mexico*, ICSID Case No. ARB(AF)/00/03, Award, 30 April 2004, ¶ 98.

<sup>9</sup> See *Crystallex International Corp. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/11/2, Award, 4 April 2006, ¶ 578.

<sup>10</sup> See *TECO Guatemala Holdings, LLC v. Guatemala*, ICSID Case No. ARB/10/17, Award, 19 December 2013, ¶ 458.

<sup>11</sup> See *Pope & Talbot v. Canada*, UNCITRAL Award on the Merits of Phase 2, 10 April 2001, ¶ 79; *Feldman v. Mexico*, ICSID Case No. ARB(AF)/99/1, Award, 16 December 2002, ¶¶ 181, 183.

31. Under this standard, Mexico, by and through the actions of its agencies and instrumentalities as described above, has breached its obligation to afford Talos national treatment under Article 14.4.

#### **IV. Relief Sought and Damages Claimed**

32. Talos will seek full compensation for the losses and other injuries to its investments suffered as a result of Mexico's breaches, with damages expected to exceed [REDACTED] reflecting the difference between the value of the Contract with and without the Treaty breaches, as well as interest, costs, and such other relief as the arbitrators deem appropriate.

33. Talos reserves the right to amend this notice to include additional claims as may be warranted and permitted under the USMCA.

34. Talos stands ready to commence consultations with Mexico. Talos is willing and open to discuss potential alternatives that could lead to an amicable solution satisfactory to the interests of all Parties.

Very truly yours,



R. Doak Bishop  
King & Spalding LLP