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Recent developments in the Orinoco Belt

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As reported by the international and Venezuelan press, on January 8 2007 Hugo Chávez, the President of Venezuela, announced that “the extra-heavy oil projects in the Orinoco Oil Belt must come back to the hands of the state”.

The Republic, through the state energy company PDVSA, took over these projects on May 1 2007. The BBC reported the event as follows: “Four projects taken over in the Orinoco Belt – which can refine about 600,000 barrels of crude oil a day – reverted to state control at midnight local time.”

Background

In 1975 the Venezuelan state nationalised the exploration, production, manufacture or refining, storage, transportation by special means and commercialisation of hydrocarbons by means of the Nationalisation Law.

In 1997, pursuant to Article 5 of the Nationalisation Law, several international oil companies entered into association agreements with several PDVSA subsidiaries, in order to jointly undertake hydrocarbons activities in relation to heavy and extra-heavy oil in the Orinoco Belt of Venezuela. These association agreements were one of the exceptional cases in which the Nationalisation Law allowed PDVSA to establish partnerships with the private sector.

In order to implement his decision regarding heavy oil, among other controversial decisions announced at the same time, the president was given ample powers to legislate by means of decrees with the force of law, under

an enabling law that was approved by the National Assembly and published in the Official Gazette of February 2 2007.

Under this Enabling Law, Chávez issued a Decree, which was published in the Official Gazette of February 26 2007, pursuant to which hydrocarbons activities related to heavy oil shall be transferred to *new empresas mixtas* (mixed companies). These were to be created in accordance with the Hydrocarbons Organic Law of 2001 as further amended in 2006, which was published in the Official Gazette of May 24 2006.

Mixed companies

According to the Hydrocarbons Law, mixed companies are corporations in which the Republic must own, directly or indirectly, more than 50% of the equity.

The Enabling Law provides the assumption by the Republic, “directly or through companies that are exclusively owned” by the Republic (this covers PDVSA and its subsidiaries), of the control of hydrocarbons activities in heavy oil under the association agreements. It also states that this control may be exercised by the Republic through mixed companies

The Decree reduces private participation in mixed companies, since it provides that the Republic, through PDVSA (by means of a subsidiary), must own at least 60% of their equity.

The Decree also provides for negotiations between the parties to the association agreements with respect to their participation in mixed companies; and Article 4 of the Decree establishes a four-month term, starting on February 26 2007, to conclude such negotiations, after which the same Article establishes a two-month period for the National Assembly to approve the agreements reached in them.

However, Article 3 of the Decree refers to “the transfer of control of all the activities performed by the associations to the state-owned

company”, under a transfer process ending on April 30 2007.

There is a contradiction between the transfer of control date of April 30 2007 and the four-month negotiation period (to which a two-month period must be added, in order to obtain the National Assembly’s approval). In fact, on May 1 the Republic took over the operation of the projects, while the negotiations continue and the mixed companies have still not been formed.

Other relevant provisions of the Decree

The Decree states that the infrastructure, the transportation services and the upgraders of the entities under the association agreements shall be “freely used”, presumably by PDVSA or an entity controlled by PDVSA. It does not specify who can freely use such assets and services, but it gives the Ministry of Energy the power to establish guidelines as to such use and to determine the price to be paid if the parties do not reach an agreed price.

The Decree also states that the areas to be allocated to mixed companies cannot have an extension of more than 100km².

Banking and capital markets

Recommended firms

Tier 1

Baker & McKenzie
D'Empaire Reyna
Rodner Martínez & Asociados
Rodríguez & Mendoza

Tier 2

Bermúdez Nevett Mezquita López
Mendoza Palacios Acedo Borjas Páez Pumar & Cía
Travieso Evans Arria Rengel & Paz

Tier 3

Aarons & Asociados
Hoet Pelaez Castillo & Duque
Squire Sanders & Dempsey
Tinoco Travieso Planchart & Núñez

Tier 4

Despacho de Abogados miembros de
Macleod Dixon
Torres Plaz & Araujo

Mergers and acquisitions

Recommended firms

Tier 1

Baker & McKenzie
D'Empaire Reyna
Mendoza Palacios Acedo Borjas Páez Pumar & Cía

Tier 2

Anzola Raffalli y Rodríguez
Despacho de Abogados miembros de
Macleod Dixon
Hoet Pelaez Castillo & Duque
Rodríguez & Mendoza
Squire Sanders & Dempsey
Tinoco Travieso Planchart & Núñez
Torres Plaz & Araujo

Project finance

Recommended firms

Tier 1

Baker & McKenzie
Rodner Martínez & Asociados
Rodríguez & Mendoza

Tier 2

D'Empaire Reyna
Despacho de Abogados miembros Macleod
Dixon
Mendoza Palacios Acedo Borjas Páez Pumar & Cía
Squire Sanders & Dempsey
Tinoco Travieso Planchart & Núñez
Torres Plaz & Araujo
Travieso Evans Arria Rengel & Paz

In Venezuela, in the words of a local lawyer, “the government has its financial industry wrapped around its finger”. All banks are required to have close to 40% of their assets in government debt, and are obliged to grant loans to certain “subsidised sectors”, such as agriculture and tourism, at preferential rates. This has led the banking industry to become more creative in developing products for investors that do not run afoul of government restrictions.

These proscriptions mean a great deal of preventative work for lawyers. Rather than working to effect large transactions, which are not being rushed to market, firms are focusing on compliance work and advising on regulatory matters for their financial clients.

In August 2008, the country's president, Hugo Chávez, announced the nationalisation of Banco de Venezuela, a potentially disastrous move both for the bank - which many expect will experience a drop in standards - and for the wider market.

The government's planned purchase of Banco de Venezuela from Grupo Santander is not an isolated incident: Chávez's government has policy of acquiring high cash flow companies with high employment in strategic industries. In recent years, the electricity, oil, gas and telecoms industries were all nationalised. Many target companies choose to settle with the government rather than go to court and spend the time and money to fight a potentially losing battle. On the other hand, some do not want to create a precedent in which any dictator can abolish contracts with impunity, and these companies frequently resort to the courts or international tribunals to enforce their rights.

Because of the threat of nationalisation, investment into Venezuela from outside of Latin America is negligible. But there are regional investors coming from countries like Colombia, Argentina, Mexico and Brazil. Many of these are companies with existing operations in the region who are looking to expand and are not as dissuaded by the risk associated with the Venezuelan regime. But the notion of immunity was disabused when Venezuela nationalised Argentine steelmaker Ternium Sidor in April 2008.

There are also multilateral acquisitions that are in essence global deals that require local counsel handle the acquisition of Venezuelan subsidiaries. The Venezuelan segment of these transactions may be purely incidental, but work is work.

Project finance is generally slow, considering the country's punitive exchange controls and the government's hostility towards the private sector. There has been speculation from Russian and Vietnamese companies intending to enter into joint ventures with the

Venezuelan state oil company, PDVSA, but so far few projects have come to pass.

Baker & McKenzie

Baker & McKenzie benefits from a very reputable brand name, and its positioning at the top of all practice areas suggests that it is meeting these high expectations. “Baker has expertise in all areas and we feel very comfortable with the advice that they are giving us,” says a client. “In terms of advising on the exchange control regulations and corporate matters, they are particularly good.”

On the banking side, the firm this year counselled Banco de Venezuela as lead arranger for a \$93 million syndicated loan to Cervecería Regional. This was the largest syndicated bolivar-denominated loan in Venezuela.

The capital markets have been generally quiet, but Baker & McKenzie has been involved in a number of the deals that have gone to market in the last year. In June 2007, the firm represented Toyota Services de Venezuela in the structuring and issuance of \$186 million unsecured bonds. This was the largest local offering of unsecured bonds by a non-banking private-sector corporation in the history of the Venezuelan capital markets.

The firm has been involved in some instances of cross-border investment into Venezuela over the last year. In August 2007, the firm represented Oxiteno, the Brazilian buyer of Arch Chemicals Andina for \$7.6 million. This acquisition may signal the start of investment by Brazilian companies in the chemicals industry in Venezuela.

In project finance work, the firm represented Gold Reserve in its offer and sale of \$13.5 million notes, which were issued to finance the Brisas gold mine project.

Leading lawyers

Carlos Delgado
Eugenio Hernández-Bretón
Roberto Mendoza
Maritza Meszaros de Jeffcoat

D'Empaire Reyna

Recognised across Venezuela as a leader in corporate work, D'Empaire Reyna has consistently been involved in some of the most important transactions in the country. The firm does not seem to be suffering any serious ill effects from the departure of name partner José Rafael Bermúdez last year.

Following Hugo Chávez's nationalisation of Ternium Steel in April 2008, the company attempted negotiations with the government to retain 10% of Sidor, the company's Venezuelan arm. D'Empaire Reyna represent-

ed Argentina and Ternium's Argentine parent company, Technit, in the negotiation process. At the end of April, Venezuela issued a decree stating that it would take control of all the steelmaker's operations.

Led by Carlos Omaña, the firm represented Deutsche Bank and Barclays Capital when the banks acted as managers in the Venezuelan government's issuance of \$4 billion bonds. The bonds were placed in the local market, with half of those issued going to companies in the foods and capital-goods sector in order to assist in the purchase of imports. This move was intended to ground rising interest rates and stall inflation.

D'Empaire Reyna continues to represent foreign corporations on the Venezuelan leg of global acquisitions. The firm represented US cable producer General Cable in the Venezuelan portion of its \$710 million purchase of Freeport-McMoran Copper & Gold's cable business. This transaction was one of the largest in Latin America, and included the acquisition of factories and distribution centres in 19 countries across Latin America, Asia and Africa.

Leading lawyers

Geraldine d'Empaire
Fulvio Italiani
Carlos Omaña
Gustavo Reyna
Arnoldo Troconis

Mendoza Palacios Acedo Borjas Páez Pumar & Cía

"Considering that the country is Venezuela, and it is a very unpredictable environment, Mendoza Palacios did a very good job," says a client, adding: "They are responsible, calm and give practical and professional advice."

The firm is best-known for advising Citibank, which has been a regular client since 1917, in many of its dealings in Venezuela. The firm is advising the international syndicate of bank lenders, led by Citibank, with regard to the \$810 million financing of Fertilizantes Nitrogenados de Venezuela. Planned and existing price controls imposed on Venezuelan sales of fertilisers complicated the transaction.

Mendoza Palacios has worked on a number of nationalisations. Carlos Eduardo Acedo led the team that represented the syndicate of bank lenders, led by BNP Paribas, which granted \$3.5 billion in 2000 for the financing of the Hamaca oil project. The firm is now advising the banks with respect to the status of the Hamaca project following its nationalisation in 2007.

Mendoza Palacios has also been active in M&A. In 2007, the firm counselled Compass

Group with respect to the sale of all its Venezuelan subsidiaries to Luxembourg's Argyle Leisure Fund. The firm also represented Freeport-McMoran Copper & Gold in the Venezuelan portion of the international transaction whereby General Cable purchased Phelps Dodge International for \$710 million. The deal included the acquisition of subsidiaries in several countries, including two Venezuelan companies.

Leading lawyers

Manuel Acedo Sucre
Carlos Eduardo Acedo
Carlos Bello
Arminio Borjas

Rodner Martínez & Asociados

"Rodner Martínez & Asociados is very small but very good," says a competitor of the firm. Rivals describe the firm as a banking and finance boutique, with the talent and experience to work on the most complex financial transactions in Venezuela.

The firm's client list is heavy on financial institutions, and includes numerous international players such as Lehman Brothers, Citibank, UBS, Société Générale, and the World Bank.

The firm's corporate work has been growing. In September 2007, the firm advised the Brazilian private-equity group GP Investments in its \$1 billion purchase of the Latin American drilling and service businesses of the US drilling contractor Pride International. The fund is financing the acquisition with \$600 million debt and \$400 million equity investment from GP Investments' subsidiaries and co-investors. The newly acquired assets include barges, rigs, and service businesses in eight Latin American countries.

In June 2008, three partners, who focused primarily on tax and finance, left Rodner Martínez to join a competitor. With such a small size to begin with, the departure could make an impact. But the firm's expertise in banking and finance matters will likely continue to make it a priority choice for clients that need legal advice on complex financing deals.

Leading lawyers

Jaime Martínez-Estévez
James-Otis Rodner

Rodríguez & Mendoza

Rodríguez & Mendoza is a relatively small firm primarily involved in financing. Since its founding in 1910, its lawyers have been at the forefront of developments in Venezuela. The

firm is still known among peers as being rather traditional and conservative, but it has managed to grow its associate ranks at an impressive rate over the last couple of years.

Rodríguez & Mendoza has particular expertise in the energy industry. The firm does significant work on oil-and-gas projects such as Cerro Negro, Sincor Project and Petrozuata. The firm also represents Fondo de Inversiones de Venezuela, which is the state agency responsible for the nationalisation of energy projects. Given the tendencies of Hugo Chávez and his administration, this government body is very likely to remain active for the near future.

Leading lawyers

Reinaldo Hellmund

Other notable firms

Aarons & Asociados has fielded a small team of lawyers that services mostly banks and financial institutions. In the past year, the firm has been involved in structured finance work, including advising Banco Guyana in its acquisition of \$150 million structured notes and advising Banco Caveni in a similar acquisition of \$365 million notes. The firm also provides advice on regulatory matters to clients in the financial services industry. The firm's founding partner, Fred Aarons, worked as corporate counsel at Citibank for a number of years, where he gained valuable in-house experience in banking and securities regulations.