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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 nationalized the exploration, production, manufacture or refining, storage, transportation by special means and commercialization of hydrocarbons by means of the Nationalization Law.

In 1997, pursuant to Article 5 of the Nationalization 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 Nationalization 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
Mendoza Palacios Acedo Borjas Páez Pumar& Cía
Rodner Martinez & Asociados
Tier 2
Bermudez Nevett Mezquita López
Rodríguez & Mendoza
Travieso Evans Arria Rengal & Paz
Tier 3
Aarons & Asociados
Despacho de Abogados miembros de Macleod Dixon
Hoet Pelaez Castillo & Duque
Squire Sanders & Dempsey
Tinoco Travieso Planchart & Núñez
Torres Plaz & Araujo

Mergers and acquisitions

Recommended firms
Tier 1
Baker & McKenzie
D'Empaire Reyna
Mendoza Palacios Acedo Borjas Páez Pumar& Cía
Squire Sanders & Dempsey
Tier 2
Anzola Raffalli y Rodríguez
Despacho de Abogados miembros de Macleod Dixon
Hoet Pelaez Castillo & Duque
Rodríguez & Mendoza
Tinoco Travieso Planchart & Núñez
Torres Plaz & Araujo

Project finance

Recommended firms
Tier 1
Baker & McKenzie
Rodner Martinez & Asociados
Rodríguez & Mendoza
Tier 2
D'Empaire Reyna
Despacho de Abogados miembros de Macleod Dixon
Mendoza Palacios Acedo Borjas Páez Pumar& Cía
Squire Sanders & Dempsey
Tinoco Travieso Planchart & Núñez
Torres Plaz & Araujo
Travieso Evans Arria Rengal & Paz

The nationalization policies of Venezuelan president Hugo Chávez are well documented, but it is interesting to see how the Venezuelan business community behind the headlines has been affected. The government has been on a shopping spree, intervening in the economy more than ever in the past 25 years. Oil and gas, power generation and distribution, and telecoms are the favourite targets for government acquisition.

A typical example is the majority stake purchased by the government in CANTV, the state-controlled fixed-line telecoms company. The government then announced it was interested in acquiring the shares still outstanding. Although companies effectively have little choice but to sell, there is a process for negotiations. The administration is smart enough to realize that it needs private investors, but it does seem to want to change the players that control the economy. There are no seizures of assets without compensation, which seems to be paid promptly, and in cash; but some have noted that fair market value is not always paid. Industries not targeted by the government are affected by other issues, including price controls, regulatory issues and credit restrictions.

The key to these policies is Venezuela's oil revenues. There is a lot of oil money, and it has affected the way business is conducted. With the government buying up leading industries, the capital markets are lifeless. There are no initial public offerings, and practically no equity offerings of any kind. The electric company and telephone company used to be listed, but they have been expropriated, so there are very few share issuances. Since these were the two most heavily traded shares on the exchange, the equity markets dried up as soon as the government acquired them.

Coincidentally, the local banks have high amounts of liquidity – those petrodollars need to be deposited somewhere. The government has tried to force the banks to invest in certain areas, such as tourism, housing and agriculture. Mortgages and agricultural loans are readily available, as is consumer lending; cynicism aside, this is a government that believes it is acting on a populist mandate. This is only possible because of the amount of oil revenue washing into the country.

There is a certain irony that the markets will eventually be forced open, if only a bit. The energy sector is one that needs enormous amounts of infrastructure development and maintenance. This favourite government industry will eventually require significant project finance deals in order to ensure oil production does not suffer – it may be extremely capital-intensive industry, but the government's fate is inextricably linked to the amount of oil produced by Venezuela.

There is a lot of work for the financial law firms at the moment, with all the nationalization projects undertaken. Large Venezuelan firms like D'Empaire Reyna still participate in projects like the CANTV deal or the takeover of electric utility EDC. While the government has recently begun to use foreign counsel for its transactions, that hasn't affected the local lawyers too much. The international law firms still turn to local counsellors for guidance.

But there is no growth anywhere, only consolidations and closings. When neighbouring Colombia suffered political, economic and security turmoil more than a decade ago, Venezuela became a safe haven for Colombian companies. Today, the neighbours are witnessing a reverse migration, away from Venezuela and into Colombia. Perhaps more than anything else, this is the best indicator of what business is like in Venezuela.

Baker & McKenzie

Baker & McKenzie has maintained a presence in Caracas for more than half a century, ever since Malcom Caplan, Ramon Diaz and Bill Gibbons started the Venezuelan branch of the firm in 1955. The firm has built quite a legacy since then, and created a reputation in the market that places it as a top-ranked firm in all categories. One rival partner said: "Baker & McKenzie has been around a long time, and is always around important transactions. They deserve their ranking." The firm maintains an office in Caracas, as well as in Venezuela's third-largest city Valencia, an important regional centre for commercial and industrial projects.

The firm represented the joint venture formed from Lagoven, Wilpro Energy Services, Maxus Energy and The Williams Companies in the El Furrial oilfield project. This is one of Venezuela's largest areas of oil reserves. The firm advised in all aspects of the creation and development of El Furrial, including negotiating terms for financing from the Overseas Private Investment Corporation.

Baker & McKenzie also represented a Taiwanese aeroplane leasing company in the purchase of several aircraft that were subleased to a Venezuelan airline. The firm also represented the Export-Import Bank of the United States for the $270 million financing of the Comsigua hot briquetted iron facility in Matanzas. This is a joint venture including Kobe Steel, Hanbo Steel, Tubos de Acero de Mexico, CVG Ferrominera Orinoco, the International Finance Corporation, and five Japanese trading firms.

Changes in the marketplace have affected many firms, and Baker & McKenzie might be one. At least one partner at a competing firm has commented on the reduced profile that Baker & McKenzie has presented recently. It will be worth tracking the firm's activities over the next year to see if it can sustain its storied past in Venezuela.

Leading lawyers
Carlos Delgado
Eugeni Hernández-Bretón
Roberto Mendoza
Maritza Mészáros

D'Empaire Reyna

Despite all the turmoil in the Venezuelan markets, D'Empaire Reyna Abogados pushes forward with high-profile financing and acquisition deals. The firm is in its 35th year and has established an international clientele that is keeping the firm busy. It was reported that partner José Rafael Bermúdez left in early 2007, incurring the name change. A partner at a leading competitor said: "Bermúdez was a big rainmaker for M&A, so I'd like to see how the firm does."

For the moment at least, mandates are no short supply. D'Empaire advised the Japan Bank for International Cooperation, which led a syndicate to create a $3.5 billion financing agreement for Japanese trading companies Marubeni and Mitsui in a deal which closed in February 2007. The two companies were to use that agreement to finance the purchase of petroleum from state oil company Petróleos de Venezuela (PDVSA). This is part of an effort from the Japanese government to diversify the country's petroleum supply source.

Venezuelan mobile phone company Digitel was sold by TIM International to Telefónica Móviles subsidiary Telvenco in January 2006. Digitel had been in play for some time, with antitrust considerations blocking at least one sale. D'Empaire advised TIM in the $425 million deal that is part of a consolidation effort by Telvenco, which plans to merge two other providers with Digitel.

The firm also played a role in the CANTV acquisition, which exemplifies the conditions in the Venezuelan financial markets. Fulvio Italiani led the team working with client Teléfonos de México (Telmex) agreed to acquire Verizon's full 28.5% stake in CANTV. This was part of an effort by Mexican billionaire Carlos Slim to expand his telecoms reach into new markets through Telmex and mobile subsidiary América Móvil. Slim would have paid $677 million for CANTV, the Venezuelan segment of a $3.7 billion tri-country effort.

The April 2006 deal was pending approval when President Chavez entered the mix, announcing in January 2007 that the government would be purchasing a stake in CANTV. Ultimately, Venezuela paid Verizon $572 million for that 28.5% stake and now owns more than 85% of CANTV.

Leading lawyers
José Rafael Bermúdez
Fulvio Italiani
Carlos Omaña
Gustavo Reyna
Arnoldo Troconis

Mendoza Palacios Acedo Borjas Páez Pumar & Cía

One of Venezuela oldest firms – the origins of the firm extends back to 1896 – Mendoza Palacios Acedo Borjas Páez Pumar & Cía confirms its top-tier ranking with several important deals. The firm has 40 lawyers, including 13 partners, and has an office in Valencia in addition to its Caracas headquarters.

Leading Mendoza Palacios in a key financing deal were partners Oswaldo Páez and Carlos Acedo. The firm represented the consortium of Va Tech Hydro, Escher Wyss, and Voith Siemens Hydro Power Generation in obtaining €46 million for the development and rehabilitation of the Guri Hydropower Plant. Owned by CVG Electrificación del Caroní, the state-owned hydroelectric facility, Guri generates more than 70% of the country's electrical production.

Like many other law firms, Mendoza Palacios has been quite busy representing clients in nationalization projects. The most convoluted was the CANTV tender offer. Mendoza Palacios represented Spanish telecommunications company Telefónica in Venezuela. Telefónica was a minority shareholder since Venezuela privatized telecoms company CANTV in 1991. The present administration embarked on a campaign to nationalize CANTV in January 2007; Venezuela now controls 86.5% of CANTV and has made a bid for the outstanding shares including the 6.9% owned by Telefónica. The government has put aside $1.3 billion for this entire process, including $572 million for a 28.5% stake owned by Verizon. That valuation suggests that Spanish company's shares come in at $138 million.

Mendoza Palacios is continuously participating in other nationalization projects. Carlos Acedo led the firm to advise clients in two petroleum-related deals, the Hamaca and Petrozuata projects. The firm is representing the interests of its banking clients in negotations with state oil company PDVSA and the government in both cases. In the Hamaca project, the firm is representing BNP Paribas for the restructuring of $3.5 billion debt that had been issued in 2001. PDVSA and the government are also in the process of nationalizing Petrozuata. The firm is negotiating the $2.4 billion financing that had been arranged by its client Credit Suisse back in 1997. In both cases, the lenders are working out minimal disruption to their investments, which also serves the best interests of PDVSA and the national government.

International clients of the firm include financial companies like Deutsche Bank, Citigroup Global Markets, Credit Suisse First Boston and JPMorgan.

Leading lawyers
Manuel Acedo Sucre
Carlos Eduardo Acedo
Carlos Bello
Arminio Borjas

Rodner Martinez & Asociados

The 11-lawyer firm of Rodner Martinez & Asociados is considered one of the most innovative firms when it comes to creating sophisticated financial instruments for its clients. There are not many firms in Venezuela that have the capacity to work on structured products and derivatives.

In a market with limited capital markets activity, Rodner Martínez assisted its corporate clients placing bolivar-denominated commercial paper and short-term notes. Issues are rarely placed above $120 million, with typical maturities of up to two years.

The firm was founded in 1977, and over the past 30 years has been advising international clients like Société Générale, Boeing, Lehman Brothers, Citibank, UBS, the Inter American Development Bank and the World Bank.

Leading lawyers
Jaime Martínez-Estévez
James-Otis Rodner

Rodríguez & Mendoza

Rodríguez & Mendoza began advising international clients in 1925, fifteen years after starting its local operations. In the restricted environment that is Venezuela's financial markets, the 30-lawyer firm has been able to position itself in several leading deals. Rodríguez & Mendoza has been involved in the sale of various industries, including banks, sugar mills and hotels, to the government. It has also advised clients through acquisition transactions and in financing deals.

An important deal for the Venezuelan oil industry was the financing obtained for the firm's client, Japanese trading company Marubeni. In a joint venture with Mitsui, another trading company, Marubeni received a $3.5 billion financing agreement in February 2007. This was an international syndicated financing, supported by the Japan Bank for International Cooperation, for the purchase of petroleum from PDVSA, the state oil company. This was a key deal for Venezuela, as it established a formal relationship between PDVSA and the Japanese government. Concerned with its over-reliance on Middle Eastern oil, Japan has been looking to diversify its petroleum suppliers. This deal helps both governments accomplish their expansion goals.

In a cross-border deal, the firm advised the Mexican chemical company Mexichem in the acquisition of Latin American conglomerate Amanco Holding for an undisclosed amount. Amanco had operations in 14 countries across Latin American countries, the British Virgin Islands and the Netherlands; Rodríguez & Mendoza represented Mexichem in the Venezuela segement of the deal. This was an effort by Mexichem to create synergy between its PVC resin manufacturing operations, which are used to build the pipes that Amanco's plants manufacture, across Latin America.

A representative client list for the firm includes several oil production projects – Cerro Negro (a joint venture of Mobil, PDVSA and Veba Oil), Sincor Project (PDVSA, Statoil and Total Oil), and Petrozuata (Conoco and PDVSA) – and the Fondo de Inversiones de Venezuela, the state agency responsible for nationalization projects.

Leading lawyers

Reinaldo Hellmund

Squire Sanders & Dempsey

With 22 lawyers in Venezuela, Squire Sanders & Dempsey has been able to establish a strong presence in the country's financial legal circles. Hernando Diaz-Candia leads the Caracas office in deals for local and international clients alike. One of the most important services for its clients is advising on nationalization projects.

Squire Sanders advised American power company CMS Energy on the sale of its regional power company subsidiary, Servicio Eléctrico de Nueva Esparta (Seneca). State-owned PDVSA purchased Seneca from CMS in a $106 million takeover that closed in April 2007. The Squire Sanders team was led by Juan José Delgado in the deal, which came about after the Chávez administration announced it was nationalizing the country's electricity sector.

Another American energy client, PSE&G, was also swept up in the government's nationalization efforts. The company had entered into a joint venture, Turboven, with Corporation Industrial de Energia in 2001 to operate electric generation plants in northern Venezuela. Squire Sanders has been negotiating in valuation discussions to obtain a fair price for PSE&G's investment in Turboven as of June 2007.

It's not all government takeover projects; there is still some M&A activity in the country. Managing partner Hernando Diaz participated in the worldwide acquisition by its industrial gas client Linde of the British company BOC. The firm acted as Venezuelan counsel in the $16 billion deal. The resultant entity, Linde Group, is now one of the world's largest industrial gas manufacturers.

The firm has also been active in regulatory matters. It has been MasterCard's representative in the credit card association's dealing with banks in Venezuela. Investment house Transbanco turned to Squire Sanders to guide the brokerage through its incorporation and licensing.

These deals have been enhancing the firm's reputation since its merger with Steel Hector & Davis in 2005. Considering the changes in the markets since then, it is critical for Venezuelan firms to establish strong relationships with companies that can provide a work flow in different areas. Thanks to the efforts of partner Alfredo Anzola, for instance, manufacturing conglomerate Tyco has become a very important client after the Pequiven water treatment acquisition. The complicated deal required filings with the US Securities and Exchange Commission, and resolving arbitration threats, but once finished it became a showcase for how a nationalization deal can be transacted. The firm is now Tyco's lead counsel.

Leading lawyers

Alfredo Anzola
Juan José Delgado
Hernando Diaz-Candia
Maria Cecilia Rachadell
Bernardo Weininger

Other notable firms

The six-lawyer outfit of **Aarons & Asociados** returns to the *IFLR1000* rankings, participating in advisory and regulatory capacities for its banking clients, a specialty of the firm. It advised American car rental company Avis in a $3 million private placement, and also helped real-estate developer Centro Comercial Cima obtain $50 million financing for the construction of a shopping mall in Barinas. The firm has plans to expand, and already has several pending deals that will be worth reviewing next year.

The firm of **Torres Plaz & Araujo** is included because of its participation in two important transactions this past year. The firm participated in the guarantee certificate issued to the borrowers in the $1.1 billion January 2006 financing for the Hamaca oil project. Companies in the joint venture that received the financing included Phillips Petroleum and Texaco; the project has since been subject to the nationalization process. It also advised Japanese trading company Mitsui in a $3.5 billion financing agreement to purchase petroleum from state-owned oil company PDVSA in an effort by the Japanese government to diversify its oil providers.