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Implications of the Nationalization Supreme Decree on Bolivia's corporate finance legislation

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On May 1 2006 the Bolivian government issued the Nationalization Supreme Decree (the Decree), under which it reclaims for the Bolivian state the property and possession of all hydrocarbons in Bolivia. Bolivia has nationalized its hydrocarbon resources twice before – the first time by expropriating Standard Oil's assets and operations in 1937 and then later by taking the assets of Gulf Petroleum in 1969. This nationalization, however, is different from the previous instances, because in this case the state does not take the investors, assets but rather intervenes in the production of natural gas through increased royalties over lucrative exploitation ventures and by taking a controlling ownership in the share capital of certain oil production, transportation and refining companies. It is this second situation that has produced an interesting case study from a corporate finance point of view, as it is asymmetrical with existing legislation regarding the transfer of share capital in private companies.

Even though nationalization should not come as a complete surprise to the players involved, to better understand its implications it is necessary to go back a few years to the Bolivian privatization process of the nineties. In 1997 the Bolivian government, in an effort to make the exploration and exploitation of hydrocarbons more efficient, capitalized the rights and assets of the Bolivian state-owned hydrocarbons company Yacimientos Petroliferos Fiscales Bolivianos (YPFB). It did this by transferring groups of assets to public/private companies (SAMs, after their acronym in Spanish) in which a majority of the shares were held by the Bolivian state and a minority were held by YPFB workers. Shortly thereafter, through an international bidding process, it offered a 50% share capital in, and the administration rights to, the SAMs to the investor which offered the highest amount of cash to be invested in said entities. After the bidding procedure was concluded, the Bolivian state's shares were transferred to all Bolivian citizens over 21 years old at the time, and were placed in the trust of privately operated pension fund management companies.

In the hydrocarbons sector this process resulted in the certain three hydrocarbons companies: Chaco, controlled by BP/Amoco; Andina, controlled by Repsol; and Transredes, controlled initially by

Enron and Shell. Later, in 1997, the Bolivian state-owned refineries were privatized by means of a transfer of assets to Petrobras. This entire strategy was carefully planned and structured through a series of laws which included the Hydrocarbons Law, the Capitalization Law, the Pension Funds Law and related legislation.

Over the past three years, political turmoil in Bolivia has led to numerous protests and riots, resulting in the ousting of president Sanchez de Lozada. Among the rallying cries for such protests was the claim that Bolivia's hydrocarbons had been practically given away to foreign transnational companies. Vice-president Mesa, in a failed effort to remain in power and appease the masses, called for a hydrocarbons referendum which included a question regarding the retaking of the property of the shares of the capitalized hydrocarbons companies. 67% of respondents agreed with this proposal. As a result of the referendum a new hydrocarbons law was passed that prescribed the transfer of ownership of the shares of the Bolivian citizens in the capitalized hydrocarbons companies back to the state.

The Decree takes the process one step further, declaring that the shares belonging to Bolivian citizens in Chaco, Andina and Transredes are to be transferred, free of charge, to YPFB and that the pension funds, in their position as trustees of such shares, should then endorse those shares in favour of YPFB. The Decree goes on to say that the Bolivian state nationalizes the number of shares necessary for YPFB to control 50%-plus-one of the share capital in each of Chaco, Andina and Transredes. As a result, each of the investor companies would be expropriated between a 3% and a 4% share ownership and would remain as minority shareholder in each such company. The Decree goes further to state that the Bolivian state nationalizes the number of shares necessary for YPFB to control 50%-plus-one of the share capital in the Petrobras Refining Company and the Hydrocarbons Logistics Company. As a result, the shareholders of those companies were expropriated of a 51% ownership in such companies.

Never before in Bolivian history has the ownership, control and transfer of shares in a private company been decided through the issuance of a supreme decree. Such a situation creates a conflict with the Bolivian constitution, Commercial Code and the securities regulations. We note that Chaco, Andina and Transredes were all registered companies on the Bolivian stock market and their shares were publicly traded. Pursuant to the Bolivian Commercial Code, the transfer of shares must be perfected by the signature and delivery of the registered owner of the share certificates.

As a result of this conflict, and the fact that the pension funds immediately resisted the Decree, the government was forced to issue a second supreme decree (the Second Decree), which not

only had to revert the investment of a portion of the shares of Chaco, Andina and Transredes to the individual capitalization funds, but also had to oblige the pension fund administrators to transfer the shares in favour of YPFB. The pension funds were thus compelled to formalize the transfer. However, they did so under protest, and some claimed that they would question the validity and constitutionality of the two decrees.

The Second Decree did not address the problem of the nationalization of the share participation that the private investors must supposedly transfer over to YPFB in each of Chaco, Andina, Transredes, Petrobras Refinación and the Hydrocarbons Logistics Company, which transfers have naturally been rejected by the affected parties. As a result the transfer of the controlling share ownership of such companies has not yet been formalized.

As well as the private investors' claims of illegality, unconstitutionality, lack of due compensation and violation of treaty rights, the Bolivian government must now try to resolve the practical stumbling block arising from the fact that although the Decree provides for YPFB's majority ownership over certain private hydrocarbons companies, it is in conflict with the Bolivian Commercial Code and securities regulations. Furthermore, it cannot force the foreign investors to authorize the transfer of their share ownership in such companies. We understand that the Bolivian government and the affected parties are still arguing over the application of the Decree, but the outcome of the controversy could lead to litigation and legislation that modifies the way Bolivian private corporations (*sociedades anónimas*) are held and transferred.

Corporate and commercial

Recommended firms

Tier 1

Bufete Aguirre
CR & F Rojas
Guevara & Gutierrez Servicios Legales
Indacochea & Asociados Abogados

Tier 2

Criales Urcullo & Antezana
Estudio Juridico Gerke
Moreno Baldovino Attorneys
Quintanilla & Soria Abogados

Bufete Aguirre

Founded in 1940, Bufete Aguirre has an enviable strength in advising on issues relating to corporate law, despite being a relatively small firm of three partners and two associates. Respondents to *IFLR1000's* research decided that the top tier is the correct place for the firm because of its frequent appearance on key transactions. One client of the firm, meanwhile, confirmed that it was the "very well qualified" and "excellent lawyers" Fernando Aguirre and Ignacio Aguirre that give Bufete Aguirre the edge. The practice is a member of several law firm associations, including Globalaw, the International Bar Association and the Association of International Petroleum Negotiators.

The past 12 months in Bolivia have meant that there are fewer deals involving foreign investments. Notwithstanding this, the corporate and commercial market remains buoyant, largely as a

result of the Nationalization Decree and other measures taken by the current government. Among these changes infiltrated by the government, insolvency and restructuring has become more of a significant area. It comes as no surprise then, that in a transaction that closed in October 2005, the firm advised Hidroeléctrica Bolivianina in relation to its \$75 million restructuring process, and at the time of writing the firm was also advising Zurich Financial Services on the restructuring of America Textil, and Amigo in relation to its debt restructuring.

Banking mandates of the past year included providing guidance to the Inter-American Investment Corporation (IAIC) twice – first, on its loan to Oro Negro and secondly in relation to the assignment of Maderera Boliviana Etienne's IAIC debt to a local bank. It is also noteworthy that Bufete Aguirre acts as permanent external legal counsel to Banco Solidario and Infocred BIC, and also provided advice to Nafibo with respect to a trust in a local bank.

The firm also picks up its share of M&A transactions. In April 2006, for example, the Orica Mining Services Group relied on the expertise of leading lawyers Fernando and Ignacio Aguirre in relation to its stock acquisition of Dino Nobel Bolivia. The firm also acted for the CDC Group when it sold its equity stakes in both Soboce and Empresa Minera Colquiri.

Other prominent clients of the firm include AES Communications Bolivia, Givenchy, the US Embassy and the Catholic Church.

Leading lawyers

Fernando Aguirre
Ignacio Aguirre

Key contact partners

Fernando Aguirre
Ignacio Aguirre
Carolina Aguirre Urioste

Guevara & Gutierrez Servicios Legales

The prowess of Guevara & Gutierrez clearly didn't escape market commentators, who decided that the firm continues to command an enviable position in the Bolivian legal market as "a respected and well-structured firm". The experienced seven-partner, seven-associate firm is led by founding partner Ramiro Guevara, cited as "a pioneer in corporate law".

In one recent highlight, the firm landed the mandate to act for power generating company Tenaska on the \$75 million restructuring of the bond issue by state-owned Hidroeléctrica. The Inter-American Investment Corporation also sought advice from the practice on a number of deals in Bolivia, including loans with equity financing participation.

Another high-profile client, Mexican Grupo Cementos de Chihuahua, required guidance on its acquisition in September 2005 of a 46.57% participation in Bolivia's largest cement producer, Sociedad Boliviana de Cemento, and the firm also provided advice when UK company Rurelec purchased 50.01% of the share stock in Empresa Eléctrica Guaracachi from the Independent Power Corporation.

Additional clients that rely upon the Guevara include Petrobas, ExxonMobil, Coca-Cola and Adecco.

Leading lawyer

Ramiro Guevara

Key contact partners

Enrique Barrios
Ramiro Guevara
Jaime Lora

Indacochea & Asociados Abogados

Founded in 1991, Indacochea is a sizeable firm comprising two partners and 10 associates. *IFLR1000* respondents noted the strength of the firm and clients could “guarantee the expertise of Ricardo Indacochea and the team in a number of corporate issues”.

The location of the firm’s office in Santa Cruz, the region where Bolivia’s oil and gas industries are concentrated, means that the firm is an obvious choice for clients with interests in hydrocarbons and energy sector. It was fitting then that IDB and CAF called upon the firm’s services for Bolivia’s electricity transmission lines – a deal worth \$84 million. In a further standout deal the firm aided GTB in its dispute with Petrobas.

Indacochea is the official Bolivian member of the Latin American Network, an organization of commercial Latin American law firms with specializations in telecommunications, energy, project finance and commercial law.

Leading lawyer

Ricardo Indacochea

Key contact partners

Richard Indacochea
Mariana Pereira

Criales Urcullo & Antezana

Criales Urcullo & Antezana possesses considerable experience in the hydrocarbons and energy sectors, and as such acts regularly for several of the largest energy and oil corporations with operations in Bolivia. The scope of the firm has grown over the past year, with the practice now offering services in mining law. Criales has undertaken private work in this area, but has also conducted transactions for the government. As a response to client demand, the firm also opened an office in Santa Cruz.

The firm has enjoyed a steady workflow over the past year, and won roles on three noteworthy transactions – first, the \$1.5 billion Mutún bidding process, secondly, in relation to Entel’s \$300 million capital reduction, and thirdly, on EBX’s iron reduction and steel production project, which involves an estimated investment of \$148 million.

Further clients of the firm include Petrobas, Transportadora de Eletricidad and the Bolivian government.

Leading lawyer

José Antonio Criales Estrugo

Key contact partner

José Antonio Criales Estrugo

Moreno Baldivieso Attorneys

Moreno Baldivieso Attorneys makes its debut in the *IFLR1000* this year after unanimous praise from market commentators. And by winning a number of noteworthy mandates, the firm’s performance certainly backs up the market’s praise. The firm has 25 lawyers, most of which work in the firm’s La Paz headquarters, but some of which are based in the firm’s branch offices in Santa Cruz, Cochabamba, Tarija, Sucre and Potosi.

Among the highlights of a busy year, Moreno Baldivieso acted on the complex \$72 million equity restructuring of Pluspetrol, advised AmeteX in relation to the \$80 million capital stock purchase and restructuring of Bi SA, and guided Sirti through its establishment of a Bolivian hub. In a further standout transaction, Moreno Baldivieso aided Bisa Bolsa through its \$43 million purchase of Vitalicia’s capital stock.

The firm is a member of five international legal alliances – Interlaw, Federacion Interamericana de Abogados, the

International Bar Association, Asociación Intermareicana de Propiedad Industrial and L’Association de Propriété Intellectuelle.

Key contact partners

Ramiro Moreno Baldivieso
Miguel Angel Jemio
Luis Moreno