

A few ideas on Petros and other cryptocurrency transactions in Venezuela¹

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On December 8, 2017, the President of Venezuela issued Decree N° 3.196, by means of which it authorized the creation of the Superintendence on Cryptocurrency and related activities, published in the Official Gazette on the same day.

The aforementioned Decree also created the Petro, described as “of crypto-active characteristic, exchangeable for goods and services, and for fiduciary money in the national and foreign crypto currency exchanges, and that it also has attributions of commodities... since it is backed by Venezuelan oil barrels, in the form of a sale agreement with the possibility of being exchanged for physical oil.”

This description, jointly with certain declarations made by the President and the Cryptocurrency Superintendent, have generated a lot of talk regarding the Petro. Economists have repeatedly tweeted and written newspaper articles regarding the nature of the Petro.

Is it a cryptocurrency? Is it sovereign debt? Is it a new national currency? Is it a token?

On January 8, 2017, the National Assembly took the position that it is sovereign debt, unconstitutionally issued.

Under a declaratory act issued as a parliamentary “Agreement on the Issuance of the Cryptocurrency (Petro)”, the National Assembly (i) declared that the Presidential Decree which created the Petro is null and void, and (ii) agreed on alerting national and foreign players in cryptocurrency markets on the illegality of the Petro or any other obligation issued by the Venezuelan state, guaranteed by reserves of oil or any other mineral.

The National Assembly based its nullity declaration on violations of the Constitution. First, it argued that assigning oil reserves as debt guarantees constitutes a violation of Article 12 of the Constitution, which provides that oil reserves are public assets, not subject to transfer, encumbrances (inalienables) or prescription. Second, it stated that it violates Article 312 of the Constitution which requires the approval of the National Assembly for any debt issuance by the State and further indicates that the State shall only recognize obligations contracted by the legitimate authorities.

We agree with the National Assembly regarding the unconstitutionality of the Petro: We concur on the Petro being characterized, not as a cryptocurrency, but as debt, which additionally is guaranteed with sovereign assets, particularly oil reserves or any other

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“commodity established by the Nation”, reference made to gold, diamonds, coltan and gas (as indicated under Article 4 of the Decree).

Both issuing securities and granting security interests or guarantees by the State qualifies as public debt. Debt, issued without the approval of the National Assembly, is null and void. Further, oil and mineral reserves belong to the State and may not be compromised.

In very simple terms: Article 80 of the Law on Financial Management of the Public Sector defines public debt including, inter alia, issuance of securities and granting security interests and guarantees. Article 312 of the Constitution mandates that debt be approved by law. Article 12 of the Constitution provides that oil reserves and mineral reserves are not subject to transfer (evidently, except if exploited pursuant to the law). Such mandate is repeated by Article 3 of the Organic Law on Hydrocarbons. Further Article 25 of the Constitution establishes the nullity of acts that violate the Constitution. Joint and separate application of these rules leave no doubt about the conclusion that the Petro, as well as the legal instruments purportedly creating it, should be considered absolutely null and void.

But there is more to the Presidential Decree than the creation of the Petro.

At least three issues are extremely important: First, Venezuela seems to have initiated the process of formally legalizing the concept of Venezuelan cryptocurrencies in general and their mining in particular; second, a parallel foreign exchange market, based in transactions on the Petro and other cryptocurrencies, may follow quickly; and, third, other cryptocurrencies may help the government circumvent foreign sanctions, but not necessarily the Petro.

1) The government of Venezuela, by enacting the Decree, has expressly granted cryptocurrency a legal status.

We are of the opinion that cryptocurrency transactions were legal prior to the enactment of the Decree, because of the constitutional premise that, for private parties, whatever is not prohibited is actually permitted. Accordingly, since no prohibition or limitation to conducting cryptocurrency transactions existed in the Venezuelan legal regime, such transactions were valid under Venezuelan law. Such transactions were regulated by general applicable rules, which, after the enactment of the Decree, now include rules that are specific to them.

However, government officials, at different times in the past, had indicated that recourse to cryptocurrencies as means to exchange bolivars for other currencies was illegal and punishable under the regime of exchange controls. The enactment of the Decree may respond to a change of policy by the authorities who now seem to have adopted a cryptocurrency-friendly attitude.

Indeed, the Decree now sets, or establishes the ground to set, specific parameters for cryptocurrency transactions in connection with the Petro.

Article 3 of the Decree provides that its object is to provide the regulatory conditions established under the Civil Code for acquisition and sale of financial assets; application, use and development of Blockchain technology; mining; and development of new cryptocurrency in the country. Additionally, the same article indicates that such conditions shall be “of licit nature”.

In other words, the Decree and, presumably, the regulations to be enacted pursuant to the Decree set or shall set the rules applicable to cryptocurrency, which are then expressly recognized as legal by the Venezuelan government. Further, as of today, to the extent that cryptocurrency transactions comply with the few rules established under the Decree, such transactions seem to be deemed legal by the Venezuelan government.

This is particularly interesting from the point of view of energy use. In practice, cryptocurrency mining requires extreme use of energy, which is a matter critical to the Venezuelan State. The government has restricted, from time to time, electricity use by different mechanisms. Given references to mining in the Decree, it is yet to be seen to what extent the government will allow mining of cryptocurrencies in view of these restrictions.

Apart from the Decree, more regulations shall surely follow. However, as of today, we could argue that cryptocurrency transactions have been legally recognized, provided the rules under the Decree are complied with. Evidently, as new rules are issued, complying with them would also be necessary; but the essence –that is, that cryptocurrency transactions are expressly recognized as legal transactions by the State- should stand.

2) The Petro –and other cryptocurrency— may substitute other type of parallel market transactions.

The recitals of Presidential Decree refer to the need of creating an “international currency”, implying that the Petro is such currency. We are not sure what an “international currency” is meant to be under the Decree. However, such reference to the currency not being Venezuelan –but international— may respond to an attempt by the government to bypass a limitation imposed by the Constitution: Article 318 provides that the official currency of the Bolivarian Republic of Venezuela is the Bolivar. This would make any national currency –other than Bolivars— illegal.

The fact is that, regardless of the government’s characterization of the Petro as cryptocurrency and the reality of it not being such but actually a debt instrument, the Decree deals with what can be considered the issue of its convertibility as if the Petro were indeed currency. Article 5 of the Decree provides that holders of Petros may exchange Petros for another cryptocurrency. They may also exchange them, pursuant to such provision, for the equivalent in Bolivars at the exchange rate published by the “national crypto-active exchange” (casa de intercambio de crypto-activo nacional) or for other “fiduciary” currency.

The above implies two limitations:

First, Bolivars vs. Petro rate may be fixed by the national exchange, rather than float freely. If this were the case, probably no exchanges of Petro for Bolivars will take place.

Second, in theory, the Decree establishes that the Petro may only be exchanged, abroad, for “fiduciary money”. Fiduciary money is exchangeable for gold, silver, money in a bank account, etc.; while fiat money has no underlying value, that is, may not be exchanged for something of value; its use derives from the order of the issuing government, which makes fiat money the legal currency. From what we have been able to find out, we do not believe the Decree used the word “fiduciary money” as opposed to “fiat money”. We believe the Decree used the term “fiduciary money” as opposed to cryptocurrency. It is highly unlikely that the government be able to control, in foreign exchanges, that the Petro only be sold for “fiduciary money”, in strict sense. Accordingly, we believe that reference to fiduciary money was included to indicate all currency other cryptocurrency, which is the way many papers on cryptocurrency refer to money (technically, fiat money). Therefore, our interpretation is

that this second limitation does not really exist, because the Decree would allow the Petro to be exchanged for cryptocurrency and any other currency.

In any case, in practical terms, commodities, bonds, etc., are exchangeable for other securities or for national or foreign currency. As provided for under Article 5, the Petro shall be exchangeable for cryptocurrencies (without any limitation on rates or types of currency), and cryptocurrencies in turn are exchangeable into any currency. Additionally, the fact that Article 5 recognizes this must not be understood in practical terms, but in legal ones. As a matter of fact, the Presidential Decree creates a specific authorization to conduct such exchanges, which does not contradict higher hierarchy rules (such as those established by law).

This is particularly important from the perspective of the foreign exchange controls which are in force in Venezuela.

Early versions of the Law on Foreign Exchange Crimes (now replaced by the Law on Foreign Exchange Regime and Illegal Acts) both (i) criminalized exchange transactions and (ii) created an exception to such crime, by allowing swaps of Venezuelan bonds to obtain Bolívares or foreign currency. However, this exception was later eliminated and even some swap transactions, conducted during the life of the exception, were persecuted criminally. Finally, the latest version of the law eliminated the prohibition of conducting exchange transactions, other than those involving exchange authorities. Analysis of this assessment probably requires a separate paper, but in summary: The Law on Foreign Exchange Regime and Illegal Acts expressly eliminated the crime and included no rules to regulate foreign exchange transactions between private parties.

These changes, legalizing parallel market transactions in general, are now —as a result of the Decree— backed by a specific authorization regarding transactions with the Petro in particular and may be interpreted to cover transactions with other cryptocurrencies. This view can be strengthened by the argument that if a prohibition of law existed, no decree would have the authority to contradict it. Yet, since no prohibition exists, this authorization just confirms the legality of these transactions expressly and particularly.

In practical terms, cryptocurrency transactions will probably thrive under the provisions of the Decree, not because of the benefits of cryptocurrency itself, but because corporations and individuals will use cryptocurrency in swap transactions (as Venezuelan bonds were used before), under the express authorization contained in the Decree for the Petro and the implied authorization and recognition of other cryptocurrencies.

3) The use of cryptocurrency may help the Venezuelan government to make payments, circumventing the application of sanctions imposed by the government of the United States of America.

In principle, the sanctions imposed under Executive Order 13808 only apply to (i) financing the Venezuelan State, including its State-owned companies, such as PDVSA; (ii) trading in Venezuelan bonds –not excepted from the sanctions—; and (iii) making payments of dividends or other capital distributions from Venezuelan State-owned companies. However, many financial institutions have taken very conservative positions, which have in practice forbidden receiving or making any kind of payment by the Venezuelan State.

Introducing payments via cryptocurrency may help the Venezuelan State make payments – even debt payments already due— bypassing the aforementioned Executive Order or the very restrictive interpretation of such order.

However, we believe this not to be the case regarding the Petro. As indicated above, there has been much discussion regarding the Petro's nature but, in the end, the least controverted position is that the Petro is actually sovereign debt. If this were the case, then the limitations under Executive Order 13808 would be applicable if maturity is more than 30 days, which is a difficult issue to ascertain if the Petro is deemed foreign debt payable on demand. Accordingly, the Petro transactions involving United States persons –as defined by the Executive Order— or taking place in the United States, would fall within the scope of application of such order.

According to Reuters, the U.S. Treasury Department has warned American individuals and corporations that acquisitions of Petros may violate Executive Order 13808. However, as indicated above, this would not only apply to United States persons, but also to transactions taking place in the United States, which may include money changing hands through the financial institutions of the United States or cryptocurrency exchanges being located in the United States.

Accordingly, in general and even before the issuance of the Decree, cryptocurrencies –other than the Petro— may help the Venezuelan government make foreign payments, circumventing limitations deriving, in law or in practice, from Executive Order 13808. But Petro transactions –depending on maturity time— may actually be restricted by such order.

All of the above is based on the very limited information regarding both cryptocurrency in general and the Petro in particular contained in the Decree. We assume that more information –even more regulations— will be available soon regarding both. Accordingly, what we have expressed herein may need to be revised.