Market Intelligence

R&I 2020

Global interview panel led by Cassels

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Venezuela

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1 In the last year, have you seen any developments or trends in the nature and volume of insolvency filings?

In order to understand the Venezuelan situation in general and particularly the current insolvency practice, we need to focus on the general context.

During 2018, the sustained economic crisis affecting Venezuela evolved into a full humanitarian emergency, with the highest inflation rate in the world. In 2019, the humanitarian emergency continued, as did the hyperinflation process, while during the past few years a tenth of the population has emigrated, oil production has plummeted and the accumulated loss of GDP over the past six years is reported to have exceeded 63 per cent, with a further 10 per cent expected for 2019. The country's functional reserves are at their lowest levels and the local currency substantially depreciates on a daily basis. Regarding foreign currency exchange, in 2019 the Central Bank has let the official exchange rate soar to the parallel market's level and a de facto dollarisation is occurring, which the monetary authorities tolerate, and this has led to a situation that is difficult to read regarding economic possibilities.

The Venezuelan government and state-owned companies have defaulted and no organised restructuring negotiations are expected to occur any time soon. Foreign sanctions, particularly US sanctions, are also in place. Such sanctions began targeting individual government officials and later evolved to apply to transactions involving the government, including state-owned companies (now blocked by such sanctions). This affects oil production and commercialisation, and – in practice – impedes the negotiation of new debt and dealings on equity belonging to Venezuela or Venezuelan state-owned companies, among others.

From a political perspective, the government controls all public institutions, except the National Assembly (the equivalent of parliament), but the government created a Constitutional Assembly that in practice has unconstitutionally taken over the state's legislative function, displacing and de facto annulling the National Assembly. The Constitutional Assembly is not recognised by most western democracies, including those of Europe, the United States and Canada. Technically, approval from the National Assembly is necessary to issue new debt and such approval has been denied to the government.

On 20 May 2018, presidential elections were held at the behest of the Constitutional Assembly. The resulting re-election of the incumbent president for a further six-year term (beginning on 10 January 2019) has not been recognised internationally, with very few exceptions. Instead, the United States, Canada and many countries in Latin America and Europe recognise the president of the National Assembly as interim president of the country since January 2019. This dual headship of state further complicates the internal situation, where the incumbent president


Manuel Acedo Sucre


Luisa Acedo


Luisa Lepervanche

"The dual headship of state further complicates the internal situation."

keeps the control of the judiciary, police and military powers, while facing sanctions and non-recognition from Venezuela's neighbours and its major traditional trading partners.

From a commerce and industry perspective, the government has implemented important regulations to control economic activities and has taken a very aggressive and confrontational stance against the private sector. Government officials have threatened private sector companies and individuals in general terms, but also, and more specifically, persecuting and outlawing acts leading to the cessation of economic activities by privately owned companies, which have been threatened with confiscation or expropriation if they 'close their doors'.

In sum, Venezuelan companies face complicated economic conditions and in some cases it is very difficult for them to operate with profit, or – at least – without losses. In the few cases where they have been able to accumulate profits, exchange controls were used to prevent shareholders from receiving dividends and capital repatriations. Further, according to different sources (such as Consecomercio, Conindustria and Fedecamaras, private sector commercial and industrial syndicates), many companies have actually stopped operating. However, we see few formal insolvency filings.

We believe this to be so because political issues and threats affect insolvency practice in Venezuela. In analysing some examples, we find things like the following.

First, during the past few years, many companies have had important capital losses due to different factors, including the foreign exchange distortions. Under Venezuelan law, this requires their shareholders to reimburse losses and capital, reduce capital stock or liquidate the company.

Second, transnational companies with a presence in Venezuela have seen important losses abroad due to their local results, which they, because of generally accepted accounting principles, reflect in their consolidated financial statements. Accordingly, transnational corporations have had to make decisions regarding their activities in our country. Some have decided to deconsolidate their Venezuelan subsidiaries, others have decided to sell their assets or business in Venezuela and others still have taken the hit.

Third, both national and transnational companies find that doing business in Venezuela is fraught with difficulties and, in some cases, not even profitable. However, they continue to manufacture and sell products and services because of the political context. In some cases, in the hope that political and economic circumstances may change. In others, even though many operations actually translate into losses, the alternative – closing shop – may actually be worse because it implies expropriation of assets and total loss of the investment. Clorox,

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Kimberley-Clark, Smurfitt Kappa and Kellogg's took this road and the result was the seizing of their assets – a de facto expropriation – by the government, with no compensation.

In this context, filing for insolvency is probably not a good option and that is what our practice has reflected. Indeed, rather than helping our clients file insolvency claims, we have had to advise them on how to dramatically downsize or to reduce operations to a minimum without passing the threshold where confiscation might happen. In other cases, we have helped them reimburse capital losses and deal with the financial and legal aspects of their equity insufficiencies. However, in other cases and on the other side of the transactions, we have helped clients seize opportunities to buy the subsidiaries of foreign companies in Venezuela, thus relieving the head offices of targeted companies from the problems of owning their Venezuelan businesses and placing a stake in the local market in preparation for change.

Yet there is a different and very important issue to consider: insolvency of the public sector. In November 2017, we saw, for the first time, late payments of debt by the Bolivarian Republic of Venezuela and its state-owned company, Petróleos de Venezuela, SA (PDVSA). Since then, with certain exceptions, payments have stopped

"The economic sanctions imposed by the United States have affected Venezuelan debt, including bonds, in different ways."

in what is now considered a full default of the state, PDVSA and Elecar bonds. Up to November 2019, the exception was the PDVSA 2020 bond, which is – in theory – secured with part of Citgo's shares. But even in that case a default occurred in November 2019 when neither the incumbent government not the interim government paid the amount due. Also, in November, the interim government initiated a judicial procedure requesting that the New York courts declare the nullity of the bond and also the nullity of the corresponding guarantee over the shares. The bondholders and the interim government reached a stay-agreement, which suspends the procedure until May 2020, but unless an agreement on the material issues is reached, the PDVSA 2020 bond will be an issue of litigation on 2020.

Further, the economic sanctions imposed by the United States have affected Venezuelan debt, including bonds, in different ways. For instance, the Venezuelan government, including its state owned companies, have been designated blocked persons and US persons (as defined in the sanctions programme) may not deal, negotiate or transact operations with them, neither may US persons deal in 'new debt' (which includes restructuring 'old debt'). This, in practice, impedes an ordered restructuring. The interim president and his designated authorities are exempted from the limitations applicable to 'blocked persons' and therefore may be instrumental in reaching agreement with bondholders, but the limitation regarding new debt still applies. In addition, the sanctions programme has established protections for the Venezuelan state from creditors in the execution of judicial decisions (although in the case of the PDVSA 2020 bond, an exception to such protection exists and enters into force on 22 January 2020). Creditors have been organising possible courses of action, for instance the ones led by Crystallex and Conoco, particularly in light of certain judicial decisions against Venezuela and, more recently regarding the lack of payment due under the PDVSA 2020 bond. Hence, insolvency of the public sector is a major issue and many factors – including a dual state, foreign sanctions, among other – may affect the way it resolves itself.

2 Describe the one or two most notable insolvency filings in your jurisdiction in the past year.

In the very unconventional scenario described, there are several cases, reported by industrial and commercial associations, of companies closing shop. Indeed, according to the president of Conindustria, four fifths of all industrial companies have closed in the past 20 years . Consecomercio's estimate for 2019 is of a drop of 35 per cent in the commercial and services sector for 2019.

However, insolvency proceedings are few and not at all prominent. Indeed, despite some rumours regarding a consumer goods company, which were later

denied by the company itself, neither the press nor colleagues report notable cases of insolvency proceedings, in the judicial sense of the term in the private sector, possibly because of the very special circumstances already described.

However, we must refer to the current default of the state and its state-owned companies, regarding payments of bonds and promissory notes, that we believe shall eventually lead to both a very complicated negotiation involving foreign creditors, including bondholders and financial institutions, and multiple lawsuits and arbitrations before foreign tribunals and arbitration venues, which have already begun, as evidenced by procedures such as the ones led by Crystallex and Conoco, or the nullity claim regarding the PDVSA 2020 bond initiated by the interim president before the New York courts.

3 Have there been any recent legislative reforms? Is there a perceived need for reform?

No, there have been no legislative reforms concerning insolvency in Venezuela. In fact, the Commercial Code, which regulates the matter of bankruptcy and moratorium,

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has been in force since 1955. Since the rules currently in force can trace their origin to the 19th century, there is indeed need for reform. Many scholars favour an approach where the principle of continuity of the company informs the rules on bankruptcy and moratorium.

Two attempts were made to reform the rules: the first in 1966 and the second in 1988. We shall refer to the most recent one, which was led by our late partner Leopoldo Borjas, who proposed a law on bankruptcy. The draft law incorporated many changes, updating certain rules and including relevant foreign law provisions, with the idea of changing the insolvency rules in order to seek continuity of the business, rather than simple protection of creditors. However, neither the 1966 nor the 1988 proposals were approved and, thus, the rules regulating insolvency date back, in their essence, more than a hundred years.

The need for reform is also evident when one considers that the very slow and formal legal procedures for insolvency in Venezuela collide with a hyper-inflationary economy, where delays may mean the almost total disappearance of any remaining assets.

4 In the international insolvency field, has there been any legislative or case law developments in terms of coordination of cross-border cases? What jurisdictions are you most likely to have contact with?

We must again refer to this very unusual context that characterises the Venezuelan situation. In this context, the most likely developments to take place shall involve the all-out default of Venezuela, either as a state or through its state-owned companies, PDVSA or Elecar, regarding payment of bonds and promissory notes.

We believe that eventually there shall be negotiations for a debt restructuring process. However, any such negotiation shall be affected by

- the need for the approval of the National Assembly;
- the perceived illegitimacy of the re-election of the incumbent president from 10 January 2019 and the recognition of the interim president by the United States and most of Europe and Latin America; and
- the sanctions that have been imposed, among others, by the United States.

In addition, and – as explained above – international companies have dealt with the losses of their Venezuelan subsidiaries, in fundamentally three ways:

- selling them;
- deconsolidating their financial statements; or
- assuming such losses.

5 | In your country, is there a particular court or jurisdiction that sees a higher concentration of insolvency filings? What is the attraction of that forum?

As explained in the answer to question 3, there are few proceedings regarding either moratorium or bankruptcy.

6 | Is it fair to describe your jurisdiction as either 'debtor-friendly' or 'creditor-friendly' in terms of how insolvency filings proceed?

In general terms, the Venezuelan regulations on insolvency, from a procedural standpoint, are creditor-friendly. Indeed, the main concept of the rules – which as we commented on in question 3 are out-dated – is the protection of creditors in the strict sense of the concept. That is, the rules are designed to organise creditors and to help them recover their credits from the patrimony of the debtor, as such patrimony stands at the time of bankruptcy.

However, since the rules have not been modernised, they do not reflect a broader concept regarding the protection of creditors. We refer to the idea that, by helping the debtor recover or continue in business, creditors may have a higher chance of fully recovering their credits. The rules do not reflect, either, as stated, the principle of continuity of business, which is even a more modern approach to the protection of creditors.

Regarding specific creditors, we refer to the general rules of the Commercial Code, which establish two types of creditors: common creditors and creditors who have privileges or are beneficiaries of security interests. In very simple terms, the latter have pre-eminence over the former. But there is an unspoken additional advantage to a particular kind of privileged creditors: workers, who tend to be favoured over all other creditors. The tax administration is also a privileged creditor.

The Venezuelan legal system is characterised by a very overprotective set of rules regarding workers, both from the standpoint of working relationships and from the standpoint of social contributions. Additionally, courts (not only labour ones) have a general tendency to protect workers over all other parties involved in controversies. Accordingly, courts tend to favour payment to workers over any other creditor. Yet, as stated above, this is not necessary beneficial, in the long term, to such workers. Other solutions, that provide continuity of business and, thus, allow workers to keep their jobs, could actually be more useful to such workers than simply receiving their severance payments in the amount allowed by the assets that are liquidated in the bankruptcy procedure (this is especially

"Our regulations require important reforms to allow for a more business-oriented approach to prevail."

so in the midst of hyperinflation). Finding different solutions, such as capitalising severance payments credits, or liquidating part of the pool of workers to make the company viable, may be a better solution for the long run. However, as stated, our regulations require important reforms to allow for this more business-oriented approach to prevail and our judges need better understanding of long-term benefits for both business and creditors in general and workers in particular.

7 What opportunities exist for businesses wanting to purchase assets out of an insolvency, and how efficient is the process? What are the best ways to take advantage of opportunities in this area?

As indicated above, we believe that, because of the very sui generis situations involving insolvency in Venezuela, our country is a market for buyers.

Strictly speaking, buying assets out of an insolvency proceeding is complicated in Venezuela, because liquidation of assets should be as follows. First, for real estate to be sold the judge must approve such sale and, second, all other assets must be sold in auction (even though the judge may authorise private sales).

Despite the above, buyers have great opportunities outside such proceedings but within general insolvency situations – or even in situations that do not amount to insolvency but do involve accounting losses or important risks associated with political issues. Indeed, as indicated, unconventional opportunities are open to individuals and corporations with a certain degree of risk tolerance. For instance, opportunities to acquire subsidiaries of transnational corporations are an indirect way to acquire assets which otherwise could be eventually involved in an insolvency or other risky situations. Indeed, because of the economic and political situation, prices are currently low. We have seen several acquisitions in the past years in Venezuela and have worked on some very interesting ones, in which our clients were the acquirers.

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The Inside Track

What two things should a client consider when choosing counsel for a complex insolvency filing in this jurisdiction?

Evidently, extensive knowledge and practice regarding corporate finance and law are indispensable. However, two more characteristics are extremely necessary. First, a solid and transparent judicial practice – that is, a litigation department that is both knowledgeable and experienced on procedural law and transparent in its dealings with the judiciary. Second, a solid labour department, because workers tend to be a determinative factor in insolvency proceedings due to the worker-friendly tendency of the Venezuelan legal regime and its application by courts. Accordingly, when choosing counsel, we recommend not only extensive corporate experience, but also a trusted litigation and labour practice.

What are the most important factors for a client to consider and address to successfully implement a complex insolvency filing in your jurisdiction?

Filing for insolvency tends to be complicated in Venezuela nowadays because of non-legal issues. Indeed, political issues, such as confiscation and expropriation threats, suggest that it is better that insolvency should be treated outside the courts, because filing for insolvency may cause the shareholders to lose not only their company, as a business, but also their investment. In fact, in a normal context, when filing for bankruptcy shareholders may receive assets after creditors have been satisfied. However, in the current circumstances, filing for bankruptcy may translate into de facto expropriation, where shareholders are barely, if at all, compensated for their shares.

What was the most noteworthy filing that you have worked on recently?

In this very unconventional context, as explained, rather than assisting our clients regarding insolvency claims, we have helped them to legally deal with equity insufficiencies, acquire subsidiaries sold by transnational corporations, advised them in expropriation procedures, and more. However, some years ago, when conditions were different, we handled one of the main insolvency proceedings in Venezuela: the moratorium proceeding filed by Venepal, CA, the leading pulp and paper producer in Venezuela, which then evolved into a bankruptcy proceeding and, finally, ended in an expropriation. We acted as counsel to Venepal and its shareholders.

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