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Getting the Deal Through

Market Intelligence

R&I 2023

Global interview panel lead by Paul, Weiss, Rifkind, Wharton & Garrison LLP

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Legislative reforms
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INSIDE TRACK



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Venezuela

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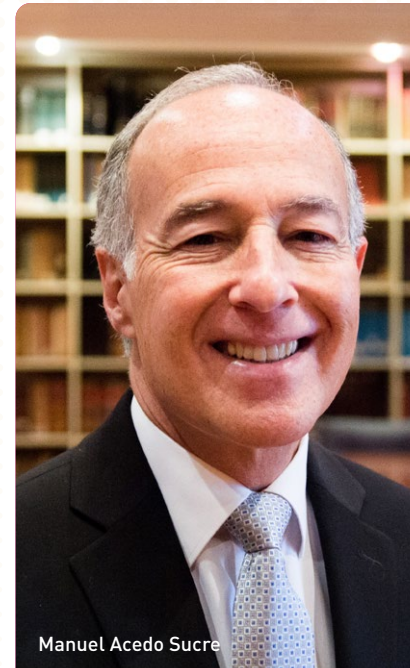
1 In the past year, have you seen any developments or trends in the nature and volume of insolvency filings?

To understand the Venezuelan situation, and particularly current insolvency practice, we need to focus on the general context. In 2018, the sustained economic crisis affecting Venezuela evolved into a full-fledged humanitarian emergency, with the highest inflation rate in the world. The humanitarian emergency, aggravated by the covid-19 pandemic, continued throughout 2021, as did hyperinflation, which continued for four consecutive years and ended in 2022.

According to the United Nations High Commissioner for Refugees, in the past few years, approximately, 7.1 million Venezuelans (out of 30 million) have emigrated from Venezuela. Oil production has plummeted, although it partially recovered in the past year and a half, and by 2021 the cumulative loss of gross domestic product was around 75 per cent, although projections by the United Nations Economic Commission for Latin America and the Caribbean suggest that there have been modest improvements since then. The country's functional reserves are at their lowest levels, and the local currency substantially depreciates on a daily basis.

Regarding foreign currency exchange, since 2019 the Central Bank has let the official exchange rate soar to the level of the unofficial parallel market. De facto dollarisation is ongoing, which the monetary authorities tolerate and which has led to a situation that is difficult to read in terms of economic possibilities; however, muted optimism permeates in respect of some economic activities.

The government and state-owned companies have defaulted, and no organised restructuring negotiations are expected to occur anytime soon. Foreign sanctions, particularly US sanctions, are in place. These sanctions began targeting individual government officials and later evolved to apply to transactions involving the government,



Manuel Acedo Sucre



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José Antonio Román

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including state-owned companies (now blocked by the sanctions). This gravely affects oil production and commercialisation and, in practice, impedes the negotiation of new debt and dealings on equity belonging to the government or Venezuelan state-owned companies, among other things.

Despite the above restrictions, in late 2022 the US foreign sanctions authority issued General Licence 41, which increased the activities that Chevron is allowed to perform in Venezuela. Chevron's authorisation is rather limited in scope, but its importance cannot be underestimated, and it has consequences for the Venezuelan economy as a whole.

From a political perspective, the government controls all public institutions, including the National Assembly (the Venezuelan parliament), which was elected in 2020; however, the electoral process that took place on 6 December 2020, in a context in which the main opposition parties and their political leaders had been banned by the electoral authorities, was boycotted by the opposition and has been internationally disputed. The results, in which 91 per cent of the seats went to the United Socialist Party (which has been in power since 2000), were rejected by the Organization of American States, Canada, the United States and most members of the European Union. The previously elected 2015 National Assembly continues to be recognised by several major democracies.

In May 2018, presidential elections were held, resulting in the re-election of the incumbent president for a further six-year term (beginning on 10 January 2019). This re-election was not recognised internationally, with very few exceptions; instead, the United States, Canada and many countries in Latin America and Europe recognised the then-president of the National Assembly (elected in 2015) as the country's interim president.

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Since then, international recognition of the interim presidency has waned, and in late 2022, the 2015 National Assembly decided to dissolve the interim government. Currently, the United States, Canada and some European countries have switched their recognition from the interim government to the 2015 National Assembly.

From a commerce and industry perspective, the government has taken important measures to control economic activities, adopting a very aggressive and confrontational stance against the private sector, with further restrictions in response to the covid-19 pandemic. Those actions have worsened the economic situation.

In the past three years, there seems to be a discreet effort by the government to open certain avenues to private investment and to cease harassing private sector actors. This began with the decriminalisation of exchange control violations and is more evident in the laissez-faire attitude to dollarisation and the quiet release of price controls.

More recently, these government efforts resulted in the promulgation of the Organic Law on Special Economic Zones and the public offering

“Even with the current laissez-faire attitudes, Venezuelan companies face complicated economic conditions.

of shares of the state-owned companies CANTV and the Bank of Venezuela; however, given its ideological bias, the government may reimpose controls or roll back these favourable economic measures for the private sector, depending on its political calculations.

The current economic environment has allowed many private sector actors to continue their activities and avoid closures. Closing businesses in Venezuela is dangerous since government officials have threatened private sector companies and individuals not only in general terms but also, and more specifically, by persecuting and outlawing conduct 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, even with the current laissez-faire attitudes, Venezuelan companies face complicated economic conditions, and in some cases, it is very difficult for them to operate at a profit, or at least without losses.

According to different sources (eg, Consecomercio, Conindustria and Fedecámaras – private sector commercial and industrial organisations), many companies have actually stopped operating; however, there are few formal insolvency filings. We believe this is because political issues and threats affect insolvency practice in Venezuela.

In analysing some examples, we find things like the following.

- In the past few years, many companies have suffered significant capital losses because of various factors, including foreign exchange distortions and the recent economic impact of the covid-19 pandemic on commerce and services. This has meant that, under Venezuelan law, their shareholders were required to reimburse losses and capital, reduce capital stock or liquidate the company.





- Second, transnational companies with a presence in Venezuela have seen significant losses abroad because of their local results, which, because of generally accepted accounting principles, are reflected in their consolidated financial statements. Accordingly, transnational corporations have had to make decisions regarding their activities in Venezuela. Many have decided to deconsolidate their Venezuelan subsidiaries, others have decided to sell their assets or businesses in Venezuela, and others have taken the hit.
- Third, both national and transnational companies find that doing business in Venezuela is fraught with difficulties and, in some cases, is not even profitable; however, many continue to manufacture and sell products and services because of the political context – sometimes, in the hope that the political and economic circumstances may change. Some companies have adjusted to a market that is less than 20 per cent of what it was five years ago; for others, even though many operations translate into losses, the alternative – closing shop – may actually be worse because it implies expropriation of assets and total loss of the investment. Clorox, Kimberley-Clark, Smurfit Kappa and Kellogg's took this road, and the result was the seizing of their assets by the government – de facto expropriation – with no compensation.

In this context, filing for insolvency is probably not a good option, and this is reflected in practice. Rather than file insolvency claims, companies may dramatically downsize or reduce operations to a minimum, without crossing the threshold where confiscation might happen. In other cases, they may reimburse capital losses and deal with the financial and legal aspects of their equity insufficiencies.

On the other hand, companies may seize opportunities to buy the subsidiaries of foreign companies in Venezuela, therefore relieving the head offices of targeted companies from the problems of owning their Venezuelan businesses while placing a stake in the local market,

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which is becoming an attractive option for some businesses or in preparation for change.

There is another different and very important issue to consider: the insolvency of the public sector. In November 2017, for the first time, late payments of debt were seen by the state and the state-owned company Petróleos de Venezuela, SA (PDVSA). Since then, with certain exceptions, payments have stopped in what is now considered a full default of the state, PDVSA and Elecar bonds. Until November 2019, the exception was the PDVSA 2020 bond, which is, in theory, secured by part of CITGO's shares. But even in that case, a default occurred in November 2019, when neither the incumbent government nor the interim government – currently dissolved – paid the amount due.

Also in November 2019, the interim government initiated a judicial procedure requesting that the New York courts declare the nullity of the bond and the nullity of the corresponding guarantee over the shares. On 16 October 2020, there was a decision declaring that PDVSA 2020 bonds are 'legal, valid and enforceable'.



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) cannot deal, negotiate or transact operations with them, nor may US persons deal in 'new debt' (which includes restructuring 'old debt').

In practice, this impedes ordered restructuring. The 2015 National Assembly and its designated authorities are exempted from the limitations applicable to blocked persons and, therefore, may be instrumental in reaching agreements with bondholders; however, this has not happened, and 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, the protection is due to end in April 2023 but may be extended). Creditors have been organising possible courses of action without much success.

It is clear that the insolvency of the public sector is a major issue, and many factors – including the recognition of the 2015 National Assembly, the non-recognition of the National Assembly elected on 6 December 2020 and foreign sanctions – may affect the way the situation 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 have been several cases of companies closing shop reported by industrial and

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commercial associations. According to the president of Conindustria, four-fifths of all industrial companies have closed in the past 20 years.

Nonetheless, the timid economic opening by the government has meant that the possibility of collapse has receded, especially in specific sectors. For instance, according to Conindustria's projections, the industrial sector could grow by 5 to 7 per cent by the end of 2023.

Insolvency proceedings are few and not at all prominent: there have not been any notable insolvency proceedings (in the judicial sense of the term) in the private sector, possibly because of the very special circumstances already described.

Finally, we must highlight the current default of the state and state-owned companies regarding payments of bonds and promissory notes, which we believe will eventually lead both to very complicated negotiations involving foreign creditors, bondholders and financial institutions, and to multiple lawsuits and arbitration proceedings before foreign tribunals and arbitration venues.



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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. The Commercial Code, which regulates the insolvency regimes of bankruptcy and moratorium, has been in force since 1955. Since the origin of the rules currently in force can be traced back to the 19th century, there is a need for reform. Many scholars favour an approach where the principle of continuity of the company informs the rules on the bankruptcy and moratorium procedures.

Two attempts have been made to reform the rules: the first in 1966 and the second in 1988. The latter 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 to seek continuity of the business rather than simple protection of creditors; however, neither the 1966 nor the

1988 proposals were approved. Consequently, the rules regulating insolvency still date back, in essence, to more than 100 years ago.

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

4 In the international insolvency field, have 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 believe that eventually there will be negotiations for a debt restructuring process; however, such negotiations will be affected by:

- the need for the National Assembly's approval, especially in view of the perceived illegitimacy of the elections held on 6 December 2020 and the persistence of the 2015 National Assembly;
- the perceived illegitimacy of the re-election of the incumbent president from 10 January 2019 and the recent recognition of the 2015 National Assembly by the United States, Canada and several European countries after the dissolution of the interim government; and
- the sanctions that have been imposed by the United States, among others.

In addition, international companies have dealt with losses by their Venezuelan subsidiaries in fundamentally three ways: selling their subsidiaries; deconsolidating their financial statements; and assuming the 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?

There are few proceedings regarding either the moratorium process 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, from a procedural standpoint, the Venezuelan regulations on insolvency are creditor-friendly. These rules are outdated, and, strictly speaking, the main concept behind them is the protection of creditors; that is, they are designed to organise creditors and to help them recover their credits from the patrimony of the debtor, as the patrimony stands at the time of bankruptcy.

Since the rules have not been updated, they do not reflect a broader understanding of the concept of the protection of creditors. We refer to the idea that by helping the debtor recover or continue its business, creditors may have a higher chance of fully recovering their interest. The rules also do not reflect the principle of continuity of business, which is an even more modern approach to the protection of creditors.

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

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The Venezuelan legal system is characterised by a very overprotective set of rules regarding workers from the standpoints of both working relationships and social contributions. Additionally, the courts (not only labour ones) have a general tendency to protect workers over all other parties involved in disputes. Accordingly, the courts tend to favour payment to workers over any other creditor.

This is not necessarily beneficial to workers in the long term: other solutions that provide continuity of business and allow workers to keep their jobs may actually be more useful to the workers than simply receiving severance payments in the amounts allowed by assets liquidated in the bankruptcy procedure (especially in the context of inflation and hyperinflation).

Finding different approaches, such as capitalising severance payment credits or liquidating part of the pool of workers to make the company viable, may be a better solution in the long run; however, the Venezuelan regulations require important reforms to allow a more business-oriented approach to prevail, and Venezuelan judges need



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a better understanding of the long-term benefits for both businesses 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?

Because of the very sui generis situation regarding insolvency in Venezuela, we believe our country is a buyer's market.

Strictly speaking, buying assets out of an insolvency proceeding is complicated in Venezuela because liquidation of assets should follow these steps: first, for real estate to be sold, the judge must approve the sale; and second, all other assets must be sold at auction (even though the judge may authorise private sales).

Despite this, buyers have great opportunities to buy assets outside insolvency 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.

There are unconventional opportunities available for 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 that could otherwise ultimately be involved in an insolvency or other risky situations. Further, because of the economic and political situation, prices are currently low.

We have seen several acquisitions in recent years in Venezuela and have worked on some very interesting ones in which our clients were the acquirers.

QUESTIONS



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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?

Obviously, extensive knowledge and practice regarding corporate finance and law are indispensable; however, two more characteristics are also necessary: first, a solid and transparent judicial practice; that is, a litigation department that is both knowledgeable and experienced in procedural law and transparent in its dealings with the judiciary. Second, a solid labour department is necessary because workers tend to be a determining factor in insolvency proceedings because of the worker-friendly tendency of the Venezuelan legal regime and its application by the 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. Political issues such as confiscation and expropriation threats suggest that it is better to deal with insolvency outside the courts because filing may result in the shareholders losing not only their company, as a business, but also their investment.

When filing for bankruptcy in a normal context, 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 compensated for their shares, if at all.

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

In the present, very unconventional context, rather than assisting our clients with insolvency claims, we have helped them to deal legally with equity insufficiencies and to acquire subsidiaries sold by transnational corporations. We have also advised them in expropriation procedures and the like.

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. The moratorium proceeding evolved into a bankruptcy proceeding and ended, finally, in expropriation. We acted as counsel to Venepal and its shareholders.



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