

THE HAMACA PROJECT: FINANCING ISSUES

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*Since the Venezuelan government decided in 1997 to move forward with the exploitation of extra-heavy crude oil in the Orinoco Belt, the financing of such projects and securing the correlative debts have given rise to legal issues that must be dealt with. The Hamaca Project (the “**Project**”) is no exception.*

Venezuela's Orinoco Belt contains the largest known hydrocarbon deposit in the world. The Hamaca area covers more than 600 square kilometers. The Project includes the development of oil fields in the Hamaca area, the transportation of the extra-heavy crude oil, through a pipeline system, to the Jose facilities in the coast of Anzoátegui, the construction of an upgrader in order to process the extra-heavy crude oil, and the commercialization of the resulting oil and its byproducts.

*The exploration, exploitation and commercialization of oil in Venezuela is reserved by law to the Venezuelan state petroleum company, *Petróleos de Venezuela, S.A. (“PDVSA”)*. For the Project, PDVSA, through a subsidiary, has entered into an association agreement with Texaco and Phillips Petroleum.*

*For this Project, **Mendoza, Palacios, Acedo, Borjas, Páez Pumar & Cía.** created a unique structure that fulfilled the expectations of all the parties involved, in order to achieve an efficient and reasonably priced security arrangement. Hence, the financing structure of the Project included a security trust. In this issue, we address some of the problems and benefits that arose from its implementation, and we discuss some of the applied solutions.*

NEGATIVE PLEDGE

In Venezuela, most oil related activities may only be performed by PDVSA or by entities resulting from the association of PDVSA with private parties. On the other hand, the Venezuelan government and its instrumentalities, including PDVSA and its affiliates, are bound by the World Bank negative pledge. This presents a problem for securing debts resulting from the financing of said activities, since the negative pledge would apply with respect to any security granted by PDVSA or its affiliates; however, it would not apply to security granted by private parties associated with PDVSA.

In the Project, this problem was solved by constituting a security trust over the percentage of the Project assets belonging to sponsors other than PDVSA.

OBJECT OF THE TRUST

This security trust included: (i) the private sponsors' rights and obligations derived from several agreements, including those arising from the association agreement between such private sponsors and PDVSA's affiliate (the "**Association Agreement**") and (ii) the private sponsors' rights over the Project assets, including the land where the plant is to be built.

This reason for this structure was the following: the rights of the sponsors under the Association Agreement include, *inter alia*, the right to operate the Project's assets as a hydrocarbon business, so although the rights of the sponsors under the Association Agreement and their rights over the assets are separate and distinct, they are to a certain extent linked. Therefore, if one of the sponsors ceases to be a party to the Association Agreement, it may still have its rights over the assets, but it would not be permitted to operate them. In consequence, the trust was established over both the Project assets and the rights under the Association Agreement in order to keep the Project as a working concern.

ENFORCEMENT OF SECURITIES

In Venezuela, activities such as the exploration, extraction, transportation and refining of hydrocarbons are deemed to be of public interest and, thus, they may be considered a to be a public service. The Project's security trust includes a clause which provides that the trustee will, if there is an event of default under the loan agreement, sell the trust assets to a third party. Before such sale, the sponsors may continue the business operation. After the sale, the purchaser may take the place of the defaulting sponsor. Thus, no interruption of the service should occur, which is an important issue if the service is considered to be of a public nature.

JUDICIAL INTERVENTION AND *PACTO COMISORIO*

Under Venezuelan law, there is an important prohibition regarding appropriation by the lender of the assets granted in security (said prohibition exists with respect to mortgages and is known as *pacto comisorio*). Further, in order to enforce a mortgage or a pledge, it is necessary to do so through judicial intervention. The assets granted in security by mortgage or pledge must be sold in a public auction by the competent court, and the price of the sale is then credited to the lenders.

In this regard, a security trust presents two important advantages: First, with respect to the *pacto comisorio* prohibition, the trust establishes that a trustee (not related to the lenders) shall sell the assets, without allowing the lenders: (i) to appoint the buyers or (ii) to establish the price of the assets to be sold. Accordingly, the lenders neither appropriate the assets granted in security, nor do they intervene in their sale. Thus, there is no violation of the prohibition of *pacto comisorio*. Second, since judicial intervention is not mandatory with respect to the enforcement of security trusts (as opposed to mortgages and pledges, where enforcement must be by a competent judge), the parties may

choose their own means of solving controversies, and in the case at hand they actually agreed to solve them by arbitration.

REGISTRATION FEES

This is a very important consideration in Venezuela, since registration fees may substantially increase the cost of the operation, especially in relation to real estate operations. The transfer of real estate assets is subject to registration in the Real Estate Registry, and the registration fee is of 1% of the value of the asset being transferred.

Any commercial trust also requires registration. However, the fee for said registration in the Commercial Registry is merely nominal, and depends upon the number of pages and other similar factors (as opposed to the amount of the transaction). Nevertheless, if the trust includes real estate, filing at the Real Estate Registry is also required. In such case, as stated, a registration fee of 1% of the value of the real estate shall apply, unless the trust is treated as a security mechanism, rather than as a transfer of property, in which case a registration fee of 0.25% of the secured amount applies. Usually, the secured amount exceeds the amount of the debt, because it covers interest payments, collection fees and litigation expenses (and may also include an additional amount to cover expected inflation) and it takes into consideration the value of the land plus the value of the plant.

In the Project, a barren piece of land (where the plant is to be built) was transferred to the trustee, so the 1% registration fee was applied to the value of such barren land. Accordingly, the amount paid in order to register the security trust was less than the amount which would have been paid if the debt had been secured by a mortgage, which would have been subject to a registration fee of 0.25% over the secured amount. In fact, the registration fees of the Project were considerably less than the ones paid for the mortgage of similar projects (e.g. the Petrozuata Project).

BANKRUPTCY

The Venezuelan Commercial Code provides that a bankruptcy procedure may be applied to any commercial corporation that has ceased its debt payments. Additionally, the same code allows the judge to consider that the cessation of payments started up to two years before the date in which the debtor is declared bankrupt. Furthermore, certain transactions made by the corporation which are detrimental to its creditors are null and void, if they take place in the ten-day period precedent to the date in which the corporation was declared to cease payments (preference period).

In this case, the Project's trust agreement was registered (both at the Commercial Registry and Real Estate Registry) before the sponsors actually started their operation so there should be no concern regarding the possibility of it being considered as taking place during the preference period.