

OIL OR GAS PROJECT FINANCING IN VENEZUELA

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Venezuela as an oil producer has developed its own formulae for project financing in this sector. In 1997, the Venezuelan government decided to move forward with the exploitation of the extra-heavy crude oil Orinoco Belt, located in the eastern part of the country. The first project was Petrozuata, a joint venture formed by Maraven (PDVSA) and Conoco, which marked the path for other projects. It is our intention herein to present the main issues in this kind of project.

Several issues may arise regarding oil or gas project financing in Venezuela (the "Project").

1 *Project vehicle:*

In these transactions one of the sponsors usually is the national oil company, Petróleos de Venezuela, S.A., or one of its subsidiaries ("PDVSA"). Most oil related activities may only be performed by PDVSA or by entities resulting from the association of PDVSA with private parties, in which case the control of the said entities must be held by PDVSA (this does not apply to gas projects).

One of the possible issues is whether PDVSA and the other sponsors ("Sponsors") will carry out the Project by means of a new company ("Newco") or by means of an unincorporated joint venture ("Association").

If the Sponsors act through an Association, then the properties, contracts and permits will have to be in the Sponsors' names; but, if they act through Newco, they will have to be in Newco's name. Implementing one or the other solution will have important tax implications.

Depending on the choice made, any eventual liability will be borne by the Sponsors (if they act through the Association) or Newco.

2 *Taxes:*

The withholding tax on interest payments is 4.95%, if the payee is a qualified financial institutions domiciled abroad ("QFI"); but it is 34%, if the payee is an ordinary corporation domiciled abroad. So one legal issue is the need to structure the transaction so that all interest payments are made to QFIs. In order to

benefit from the 4.95% withholding rate, QFIs may be appointed as lenders of record in syndicated loans or bond issues.

3 *Securities formalities and related expenses:*

In order to have a perfected security interest under Venezuelan law (i) mortgages of any kind and non-possessory pledges must be filed with the public registry (the registration fee is of 0.25% of the amount secured by the mortgage or pledge); (ii) ordinary pledges require the actual delivery of the pledged asset to the creditors or to their appointee (in the case of shares, a record is made in the shareholders' books and the share certificates are endorsed); (iii) chattel mortgages and non-possessory pledges require a governmental authorization; and (iv) commercial trust arrangements require registration with the Commercial Registry (there is only a nominal registration fee), but, if the trust assets qualify as real estate, a filing at the corresponding real estate registry is also required (the registration fee should be 1% of the value of the real estate transferred to the trustee).

Even though the registration fee for mortgages of any kind and non-possessory pledges is 0.25% of the secured amount, in case of assignments most registrars consider that the applicable registration fee is 1% of the amount of such assignment (since the assigned secured debt is treated as real estate property). So one of the issues is whether the lenders should be permitted to make assignments. This does not apply to participations.

QFLs, as lenders of record, may sell participations (rather than grant assignments).

Another option is using a trust as a means of creating a security interest. The use of trusts as security is not explicit in the Trust Law. However, it was foreseen by the legislator (Stated Purpose) and it has been used as such in several important transactions (the Petrozuata and Fertinitro project financings and the Sidor debt restructuring, in all of which Mendoza-Palacios acted as local counsel to the lenders). So a trust may be established for the purpose of creating a security interest, as opposed to the more traditional mortgages or pledges. This can be implemented as follows:

Before building the facilities, the land may be transferred to a trustee, in order to create a security interest for the benefit of the agents for the lenders (and bondholders, if any). Thus the registration fee should be of 1% of the value of the barren land. If the same property were to be mortgaged, the registration fee would be 0.25% of the amount secured by the mortgage (the amount up to which the debt is secured by the mortgaged asset). This usually exceeds the amount of the debt, because it covers interest payments, collection fees and litigation expenses. It may also exceed the value of the mortgaged asset, to anticipate inflation. Under normal circumstances, the amount secured by the mortgage covers the value of the land *plus* the value of the plant. Thus, normally, the

amount secured by the mortgage is much higher than the value of the barren land. Accordingly, a trust granted over the land before the construction (which will cover the plant after it is built) will probably be considerably less expensive than a mortgage that includes the future plant.

4 *Secured parties:*

In Venezuela, the secured party must be a creditor of the borrower. A person or corporation who is not a creditor cannot be a secured party. A mortgage or a pledge may only be granted to secure the rights of persons and corporations identified in the corresponding security documents. All of this may be an obstacle to directly securing in Venezuela the rights of the bondholders and/or a large group of syndicated banks, some of which intend to transfer their rights sometime in the future. So QFLs, as lenders of record, may hold the mortgages and pledges for the indirect benefit of all the non-registered lenders or bondholders. Rather than establishing a mortgage or a pledge to benefit a large group of constantly changing persons or corporations, the QFLs may hold the mortgages and pledges for the indirect benefit of all the non-registered lenders or bondholders.

Another possibility is to transfer the plant and/or other assets into a Venezuelan trust. Indeed, the beneficiary of the trust may be one or more agents for all of the creditors (including the bondholders, if any, and the syndicated banks).

5 *Accounts pledge:*

In Venezuela the Sponsors cannot grant pledges over accounts intended to be used in normal operations, for in order to perfect the security interest, the account must be transferred to the pledgee, thus, in practice, the pledgor cannot draw funds from it.

With a trust arrangement this problem does not arise, since the settlor may contribute an account into a trust and authorize one or more of the settlor's employees to mobilize such account, provided that there is no event of default.

6 *Pledge formalities:*

For perfecting pledges over contracts, receivables or other documents under Venezuelan law, each document has to be specifically identified in the security documents and, if it is a negotiable instrument, it must be endorsed and delivered to the pledgees or their appointee.

The alternative is contributing such documents to a trust in Venezuela. Indeed, the settlor may transfer future contracts, receivables or other documents to a Venezuelan trustee.

7 *Sale of the collateral:*

Under Venezuelan law, the secured assets cannot be sold by the holders of a mortgage or a pledge nor can they deliver any document otherwise evidencing the transfer of such assets. Sale by a judge in public auction is necessary, following a procedure. This is often an issue, because lenders may expect to have the collateral sold without any judicial intervention if an event of default occurs.

On the other hand, a Venezuelan trust agreement may impose on the trustee the duty to use the moneys in trust or the proceeds from the sale of the assets in trust, as the case may be, to pay one or more of the settlor's debts, through the creditors' agent. Further, a trust agreement may include an arbitration clause.

8 Mortgages in foreign currency:

There is some doubt in Venezuela as to the validity of mortgages established in foreign currency. Accordingly, it is advisable to establish the mortgage in Bolivars and to provide for an increase of the mortgage amount whenever there is a significant Bolivar depreciation. The 0.25% registration fee applies to the amount of each increase.

A Venezuelan trust, on the other hand, can be established in any currency. Since the trust may include a reference to a foreign currency, there is no need to amend the trust agreement in case of a devaluation of the Bolivar.

9 Enforcement of securities:

There are important limitations with respect to the enforcement of security interests over facilities for the exploration, extraction, transportation and refining of hydrocarbons. Such activities are deemed of public interest and a public service; a public service may not be interrupted; the attorney general must be notified prior to any attachment, and, in any case, the purchaser must be licensed to provide the service.