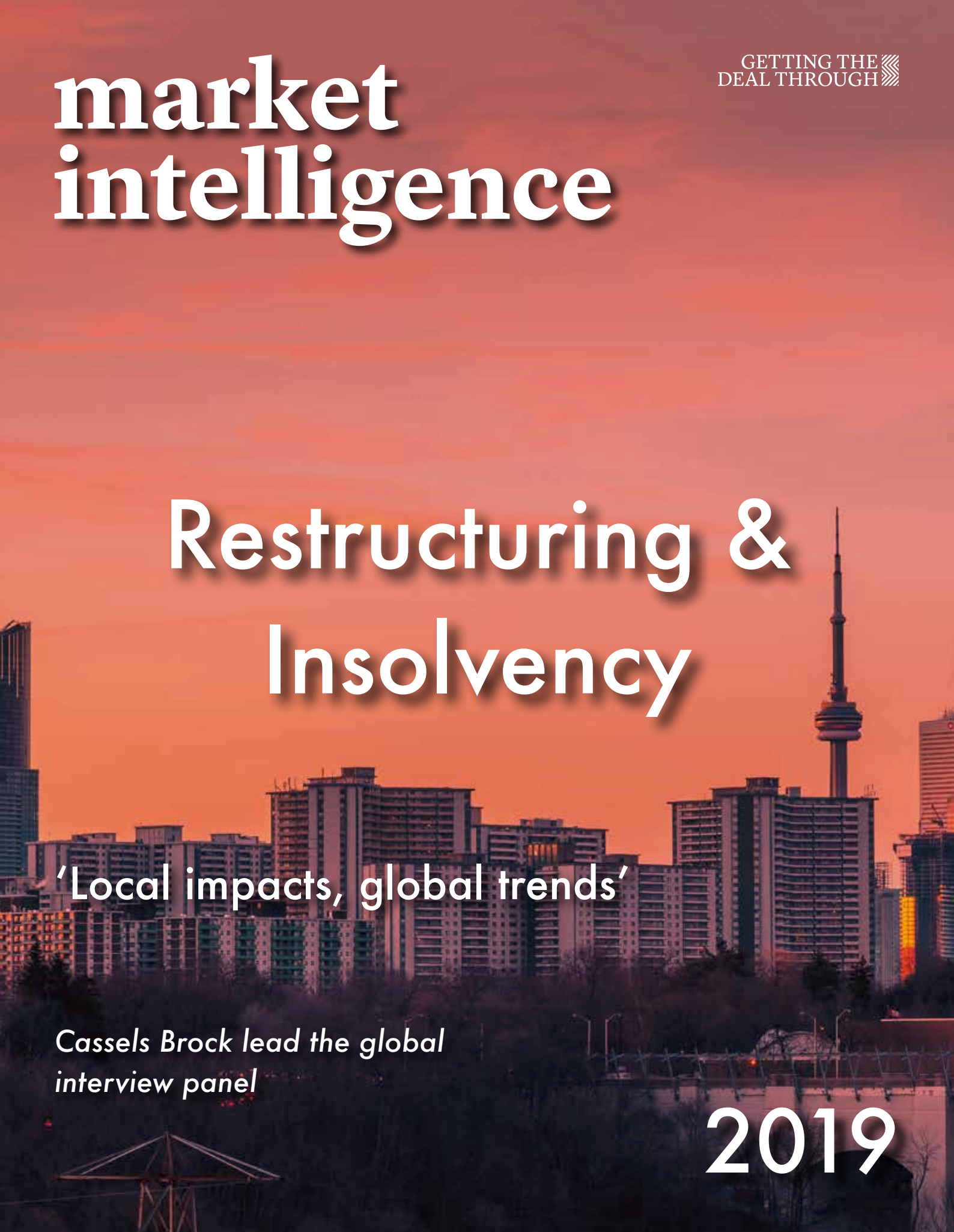

market intelligence

GETTING THE DEAL THROUGH

Restructuring & Insolvency

'Local impacts, global trends'

Cassels Brock lead the global interview panel

2019

Legislative reform • Notable filings • Cross-border coordination • Asset purchase
North America • Asia-Pacific • Europe • Latin America

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Welcome to GTDT: *Market Intelligence*.

This is the 2019 edition of *Restructuring and Insolvency*.

Getting the Deal Through invites leading practitioners to reflect on evolving legal and regulatory landscapes. Through engaging and analytical interviews, featuring a uniform set of questions to aid in jurisdictional comparison, *Market Intelligence* offers readers a highly accessible take on the crucial issues of the day and an opportunity to discover more about the people behind the most interesting cases and deals.

Market Intelligence is available in print and online at www.gettingthedealthrough.com/intelligence.

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R&I IN VENEZUELA

Manuel Acedo Sucre is a partner at Mendoza, Palacios, Acedo, Borjas, Páez Pumar & Cía. (Menpa). He practices private law, focusing on corporate law, including insolvency matters; banking and finance, including debt restructuring; taxation; real estate; and energy. Manuel completed his graduate studies at Harvard and at Tufts, and was himself a professor in graduate studies on corporate and regulatory matters at Universidad Central de Venezuela. Manuel is a director of several corporations. He is also the author of articles on corporate and tax matters, and three novels.

Luisa Acedo is a partner at Menpa. Luisa's practice focuses on corporate law and related issues. In addition to an extensive practice in the law regarding corporations, she is the author of treatises and articles on corporate issues, including corporate governance, companies' dissolution, etc. Luisa also specialises in mergers and acquisitions; banking and finance, including debt restructuring; energy; and real estate matters. Luisa taught contemporary international history at Universidad Metropolitana for eight years.

Luisa Lepervanche rejoined Menpa as junior partner, after being legal counsel to The Coca-Cola Company for Venezuela and Caribbean. She has taught legal analysis and human rights and is now teaching corporate law topics at Universidad Metropolitana. Her practice is currently focused on corporate law, mergers and acquisitions, banking and finance, private equity, real estate issues and public law. She has written articles on corporate matters, cryptocurrency, insurance and exchange controls.

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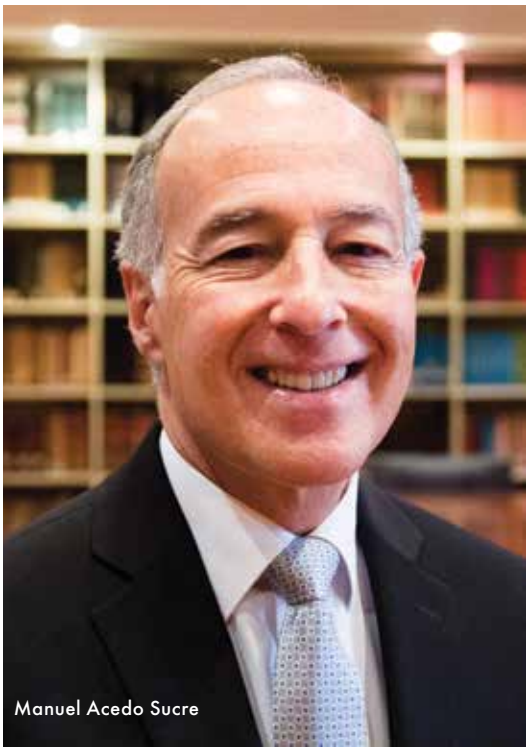

Manuel Acedo Sucre

Luisa Acedo

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

Manuel Acedo Sucre, Luisa Acedo and Luisa Lepervanche: In order to understand the Venezuelan situation in general, and, in particular, the current insolvency practice, we need to focus on the general context.

During 2018, the sustained economic crisis affecting Venezuela in recent years evolved into a full humanitarian emergency, with the highest inflation rate in the world (which the IMF recently projected for 2019 at 10 million per cent), while the accumulated loss of GDP over the last five years is reported to have been over 53 per cent. The country's functional reserves are almost depleted and foreign exchange has become scarce, and the local currency substantially depreciates on a daily basis. The resulting debt crisis has seen selective defaults on payments by the Venezuelan government and state-owned companies, and the market seems to be bracing itself for a complete cessation of payments on the foreign debt at any time. No organised restructuring negotiations are expected to occur any time soon, and any such process may be hampered by foreign sanctions, including American sanctions both to individual government officials and to certain business transactions involving the government and state-owned companies, which include new debt and dealings on equity belonging to Venezuela or Venezuelan state-owned companies.

From a political perspective, the government controls all public institutions, except the National Assembly (which is the equivalent of parliament), but the government created a Constitutional Assembly, which 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.

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, companies in Venezuela face terrible economic conditions, and in some cases it is practically impossible 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 have been used to prevent shareholders from receiving dividends and capital repatriations. Further, according to different sources (such as Consecomercio and Fedecamaras, private sector commercial and industrial syndicates), many companies have actually stopped operating. However, we see few formal insolvency filings.


Luisa Lepervanche

"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."

We believe this is because political issues and threats affect insolvency practice in Venezuela. Analysing some examples we find things like the following:

- First, many companies have had important capital losses due to different factors. Under Venezuelan law, this requires their shareholders to do one of the following: to reimburse losses and capital, to reduce capital stock or to liquidate the company.
- Second, transnational companies with a presence in Venezuela have seen important losses abroad due to their local results, which, because of generally accepted accounting principles, they reflect in their consolidated financial statements. Accordingly, transnational corporations have had to make decisions regarding their activities in our country. Some have decided to de-consolidate their Venezuelan subsidiaries; others have decided to sell their assets or business in Venezuela; and, finally, others have taken the hit.
- Third, both national and transnational companies find that doing business in Venezuela is fraught with difficulties and, in many cases, is 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 other cases, even though many operations actually translate into losses, the alternative, that is, closing shop, may actually be worse, because it implies expropriation of assets and total loss of the investment. Clorox, Kimberley-Clark and Smurfitt Kappa 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. In other cases still, 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.

But there is a different and very important issue to consider also: 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 virtually stopped, in what has been called a selective default of the state, PDVSA and Elecar bonds. Further, very basic conversations regarding the possible restructuring of debt were announced, and although some meetings were held, negotiations have not really started and are to be hindered by the National Assembly's position and the economic sanctions, such as the ones imposed by the United States of America. Creditors seem to be organising to make decisions regarding possible courses of action, particularly in light of certain judicial decisions against Venezuela, for instance

"An all-out default of Venezuela, following the current selective default, is feared by most of the international financial community."

the ones led by Crystallex and Conoco. Hence, insolvency of the public sector is a major issue.

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

MAS, LA & LL: 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 Fedecámaras, more than 9,000 companies have closed in the last 15 years. Further, Fedecámaras indicates that during 2018, 600 companies have closed.

Yet insolvency proceedings, as such, are few and not at all prominent. Indeed, neither the press nor colleagues report notable cases of insolvency proceedings, in the technical sense of the term, in the private sector, possibly because of the very special circumstances already described.

However, we must refer to the current selective default of the state and its state-owned companies, regarding payments of bonds and promissory notes, that we believe shall eventually lead to either:

- a very complicated negotiation involving foreign creditors, including bondholders and financial institutions; or
- multiple lawsuits and arbitrations before foreign tribunals and arbitration venues.

In this context, there are those that advocate more dramatic – and questionable – solutions, such as submitting PDVSA to bankruptcy proceedings or transferring its assets to other vehicles.

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

MAS, LA & LL: No, there have been no legislative reforms concerning insolvency in Venezuela. Actually, the Commercial Code, which regulates the matter of bankruptcy and(moratorium has been in force since 1955. Since the rules currently in force can trace their origin to the nineteenth 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 one in 1966 and the second one 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 one hundred years.

GTDT: 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?

MAS, LA & LL: We must again refer to the very unusual context that characterises the Venezuelan case.

In that context, we believe the most likely development to take place shall be the ones involving the default of Venezuela, either as a state or through its state-owned companies, PDVSA or Elecar, regarding payment of bonds and promissory notes. An all-out default, following the current selective default, is feared by most of the international financial community.

We believe that the most likely outcome of this default will be the negotiation of 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 sanctions that have been imposed, among others, by the United States.

In any case, such eventual negotiation will probably involve important financial markets, such as New York and London.

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 too. 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; yet, 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, etc. Yet, 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.

Manuel Acedo Sucre, Luisa Acedo and Luisa Lepervanche
Mendoza, Palacios, Acedo, Borjas, Páez Pumar & Cía.
Caracas
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In addition, and – as explained above – international companies have dealt with the losses of their Venezuelan subsidiaries, in basically three ways:

- by selling them;
- by de-consolidating their financial statements; or
- by assuming such losses.

GTDT: 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?

MAS, LA & LL: Again, there are few proceedings regarding either moratorium or bankruptcy.

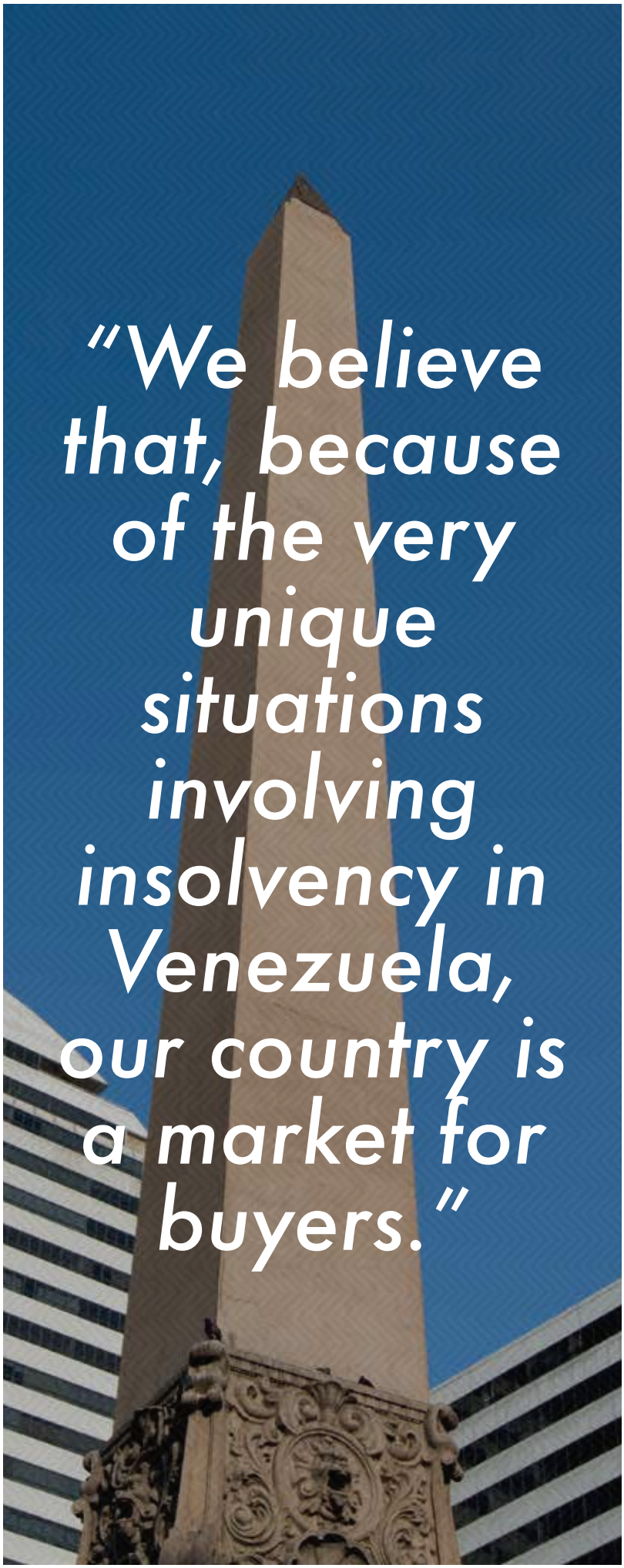
GTDT: Is it fair to describe your jurisdiction as either 'debtor-friendly' or 'creditor-friendly' in terms of how insolvency filings proceed?

MAS, LA & LL: 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 already are outdated, 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.

Yet since the rules have not been modernised, they do not reflect a broader concept regarding 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. Neither do the rules reflect, as stated, the principle of continuity of business, which is an even 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 over-protective 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



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workers to keep their jobs, could actually be more useful to such workers thanks simply to receiving their severance payments in the amount allowed by the assets that are liquidated in the bankruptcy procedure (this is especially 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. Yet, 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.

GTDT: 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?

MAS, LA & LL: As indicated above, we believe that, because of the very unique 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 above, 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 in 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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