GETTING THE DEAL THROUGH

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Volume 5 • Issue 1

Restructuring & Insolvency

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Cover: iStock.com/jgareri

Law Business Research

Published by
Law Business Research Ltd
87 Lancaster Road
London, W11 1QQ, UK
Tel: +44 20 3780 4104
Fax: +44 20 7229 6910

ISSN: 978-1-78915-089-6

Printed and distributed by
Encompass Print Solutions
Tel: 0844 2480 112

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Welcome to *GTDT: Market Intelligence*.

This is the first annual issue focusing on 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

Getting the Deal Through
London
February 2018

In this issue

R&I IN VENEZUELA

Manuel Acedo Sucre is a partner at Mendoza, Palacios, Acedo, Borjas, Páez Pumar & Cía (Menpa). Manuel practises private law, focusing on corporate law, including insolvency matters; and 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. Manuel is a director on the boards of several corporations. He is also the author of various articles on corporate and tax matters and has published three novels.

Luisa Acedo de Lepervanche is a partner at Menpa. Luisa's practice focuses on corporate issues, an area in which she has an extensive practice and on which she has authored treatises and articles, including on corporate governance and company liquidations. Luisa also specialises in banking and finance, including debt restructuring, energy and real estate matters.

Luisa Lepervanche recently rejoined Menpa as junior partner. Formerly, Luisa was legal counsel to The Coca-Cola Company for Venezuela and the Caribbean. She also taught legal analysis and human rights and worked on human rights issues. Her practice is currently focused on corporate law, banking and finance, real estate and public law. Luisa has written articles on corporate matters, insurance and exchange controls.

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

Manuel Acedo Sucre, Luisa Acedo de Lepervanche and Luisa Lepervanche: Perhaps a little context is necessary in order to understand the Venezuelan situation in general, and, in particular, current insolvency practice.

From an economic perspective, the country has been undergoing a crisis of enormous proportions. Last November, Venezuela entered into a hyperinflationary cycle, with the highest inflation rate in the world, while the accumulated loss of GDP over the past four years is reported to have been more than 35 per cent, the highest in Latin American history, with an expected decrease of 10 per cent for this year. The country's functional reserves are almost depleted and foreign exchange has become scarce, as local currency substantially depreciates on a daily basis. As a result, a debt crisis is becoming a certainty and the market expects a cessation of payments on the foreign debt at any time. Restructuring negotiations are expected soon, but the 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.

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

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, have been 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 terrible economic conditions, and in some cases it is practically impossible for them to operate profitably – 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, which are private sector commercial and industrial syndicates), many companies have actually stopped operating. Yet, we see few formal insolvency filings.

We believe this is because political issues and threats affect insolvency practice in Venezuela, as we will discuss further here.

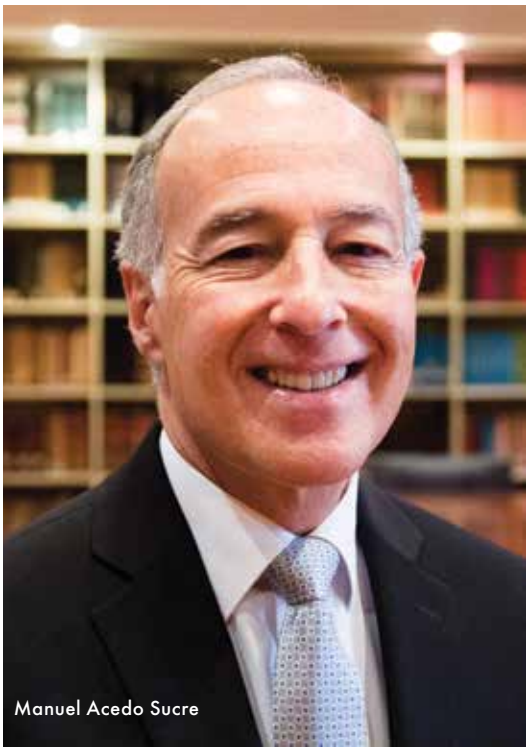
First, many companies have had important capital losses due, mainly, to foreign debts which, because of currency devaluation, have dramatically impacted their liabilities and, thus, their financial statements. Under Venezuelan law, this requires their shareholders to do one of the following: reimburse losses and capital, reduce capital stock or liquidate the company.

Second, some transnational companies have seen important losses abroad due to their results in Venezuela, 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 deconsolidate 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, 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 (ie, closing shop) may may actually be worse, because it implies expropriation of assets and total loss of the investment. Clorox and Kimberley-Clark 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. Yet 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 their head offices of the burden 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 in 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


Manuel Acedo Sucre


Luisa Acedo de Lepervanche

company Petróleos de Venezuela, SA (PDVSA). Some even refer to a selective default. Indeed, S&P Global Ratings and Fitch Ratings downgraded its already substandard long-term rating of the state and PDVSA accordingly, following this delay. In addition, very basic conversations regarding possible restructuring of debt have been conducted, but these negotiations have not really started and are further hindered by the National Assembly's position and economic sanctions such as those imposed by the United States.

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

MAS, LAL & LL: In the very unconventional scenario described, there are several cases, reported by industrial and commercial associations, of companies closing shop. Indeed, according to Consecomercio, more than 500,000 companies have closed in the past 15 years. Further, Consecomercio indicates that, at the beginning of 2017, approximately 400 companies closed daily.

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 earlier.

However, we must refer to the possible default of the state and its state-owned companies, regarding payments of bonds and promissory notes that will probably lead to either (1) a very complicated negotiation involving foreign creditors, including bondholders and financial institutions, or (2) complicated lawsuits and arbitrations before foreign tribunals and arbitration venues. In this context, there are those that advocate more dramatic solutions, such as submitting PDVSA to bankruptcy proceedings.

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

MAS, LAL & LL: No, there have been no legislative reforms concerning insolvency in Venezuela. Actually, the Commercial Code, which regulates bankruptcy and moratoriums, 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 moratoriums.

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, in essence, date back more than 100 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, LAL & LL: We must again refer to the very unusual context that characterises the Venezuelan situation.


Luisa Lepervanche

"The Venezuelan legal system is characterised by a set of very overprotective rules regarding workers, both from the standpoint of working relationships and from the standpoint of social contributions."

In this context, we believe the most likely developments to take place shall be those involving the eventual default of Venezuela, either as a state or through its state-owned companies, PDVSA or Electricidad de Caracas, CA (Elecar), regarding payment of bonds and promissory notes. An all-out 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, to take place probably some time next year. This negotiation will probably involve important financial markets, such as New York and London.

In addition, and, as explained above, international companies have dealt with the losses of their Venezuelan subsidiaries, basically in three ways: by selling them, by deconsolidating their financial statements, or by assuming the 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, LAL & LL: Again, there are few proceedings regarding either moratoriums 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, LAL & 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 debts from the patrimony of the debtor, as the 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 debts. And as we stated earlier, neither do the rules reflect 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 that 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 set of very overprotective rules regarding workers, both from the standpoint of working relationships and from the standpoint of social contributions. Additionally, the courts (not only the labour courts) have a general tendency to protect workers before 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 the workers. Other solutions that provide continuity of business, and thus allow workers to keep their jobs, could actually be more useful to the workers than simply receiving their severance payments in the amount allowed by the assets liquidated in the bankruptcy procedure.

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 extremely 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, 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 the risk of confiscation and expropriation, suggest that insolvency is best 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 a normal context, when filing for bankruptcy, shareholders may receive assets after creditors have been satisfied, but, 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 this very unconventional context, rather than assisting our clients in relation to insolvency claims, we have helped them legally to deal with equity insufficiencies and acquire subsidiaries sold by transnational corporations, and advised them in expropriation procedures, etc. 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. This proceeding 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 de Lepervanche and Luisa Lepervanche
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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 in the long run. Yet, as we said earlier, our regulatory regime requires important reforms to allow for a more business-oriented approach to prevail, and our judges need to have a better understanding of the long-term benefits for both business and creditors in general, and for 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, LAL & LL: As we already mentioned, we believe that, because of the sui generis nature of insolvency situations in Venezuela, our country is a market for buyers.

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

Despite this, there are great opportunities for buyers outside these 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 already, 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 may eventually be 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 recent years in Venezuela and have worked on some very interesting ones in which our clients were the acquirers.

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ISSN: 978-1-78915-089-6