

**THE USE OF TRUSTS AS SECURITY MECHANISMS
IN RECENT FINANCINGS IN VENEZUELA**

Arminio Borjas

Carlos Eduardo Acedo Sucre

Luisa Acedo de Lepervanche

Traditionally, debts in Venezuela have been secured by mortgages, pledges and bonds. A 1973 law established two additional instruments: chattel mortgages and non-possessory pledges. Such traditional security interests (“TSI”) were devised for simple loans between one lender and one borrower. The development of the Venezuelan economy, linked to the world through its oil sector, has included large and complicated international credit operations. Securing such financings has been a constant challenge. The TSI raise several problems, when they are used to secure syndicated loans; and they are rigidly regulated by law, especially regarding enforcement, since the secured assets must be sold by a judge in an auction, following a strict procedure. However, international lenders expect to have the collateral sold without judicial intervention and controversies to be submitted to a jurisdiction other than the borrower’s. Therefore, lenders have relied mainly on security interests established abroad, which do not adequately cover assets in Venezuela.

*Recently, an innovative approach to security interests has been implemented by **Mendoza, Palacios, Acedo, Borjas, Páez Pumar & Cía.** in the Sidor debt restructuring (steel industry) and in the Hamaca (oil sector) and Digitel (telecommunications) project financings, based on the 1956 Trust Law. The use of trusts as security is not explicit in such law, however, it was anticipated in its introductory Statement of Purpose; and the 2001 Banking Law refers to fiduciary funds being granted as security.*

The Trust Law provides that the ownership of trust assets is transferred to the trustee. In order to use trusts as security mechanisms: (A) The borrower and/or the sponsor (“**Trustors**”) contribute the assets to the trust; thus the trustee becomes their legal owner. The beneficiaries are an agent for the lenders (“**Agent**”) and the Trustors. (B) The trust agreement explicitly states that Trustors retain the use and possession of the assets, with no interference from the trustee. (C) When the debt is paid, the assets are returned to the Trustors. (D) If there is an event of default (“**EOD**”), the assets are sold by the trustee (as owner) without judicial intervention, and the price is delivered to the Agent, and any remaining balance to the Trustors.

1.- Secured parties

In Venezuela, the secured party under TSI must be a creditor of the borrower, who must be identified in the corresponding loan document. This raises obstacles to securing directly the rights of bondholders or syndicated banks, whose intention may be to transfer their rights. In order to solve this problem, in syndicated loans or bond issues, a small group of banks may be appointed as “lenders of record”, to hold the TSI for the indirect benefit of all the non-registered lenders or bondholders. However, problems may arise, such as a bankruptcy court ordering the lender of record to return a payment made by the debtor during the preference period. The lender of record would have to recover the amount from the other lenders, who may have become insolvent.

A security trust does not present this problem, since the beneficiary may be the Agent.

The trustee must be a Venezuelan bank or insurance company. The new 2001 Banking Law set the following limit regarding trusts: the total amount of fiduciary funds may not exceed five times the trustee’s patrimony. This limitation is minimized if the Trustors contribute the assets to the trust conditionally, upon verification of an EOD. In that way the assets would only be transferred in order to be sold, and this should not affect the bank’s limit at closing. However, the actual transfer to the trustee may be considered null if the Trustors go bankrupt and such transfer is made within the preference period.

The new law does not differentiate between security trusts and other kinds of trusts, even though the trustee does not (i) receive funds from the Trustors in order to invest them and (ii) administer any funds and/or assets, which are controlled by the Trustors, if there is no EOD. Banks are currently lobbying the authorities to exclude security trusts from such limit.

2.- Formalities.-

Mortgages must be filed with the Real Estate Registry (the fee is 0.25% of the secured amount); pledges require the actual delivery of the pledged asset to the creditors or their appointee; chattel mortgages and non-possessory pledges

require a governmental authorization and the document must be granted before a notary public; and trusts require registration with the Commercial Registry and, if there is real estate, filing at the Real Estate Registry (the fee is up to 1% of the value of the real estate).

Regarding chattel mortgages and non-possessory pledges, before the 2001 Public Registries and Notaries Law, registration in the Real Estate Registry was required, for a fee of 0.25% of the secured amount.

To register trust agreements in the Commercial Registry there is only a nominal fee. In case the trust includes real estate, since a filing at the Real Estate Registry is required for a fee of 1% of the real estate's value, then, if the real estate consists of land in which a construction shall take place, such fee may be alleviated by transferring the land to the trustee before building the facilities and installing the machinery, all of which shall belong to the trustee as owner of the land, with no need to pay an additional registration fee. Thus the fee would be 1% of the value of barren land). In contrast, mortgage registration fees would be 0.25% of the secured amount.

3.- Jurisdiction and enforcement

The Venezuelan judiciary works under heavy case loads with inadequate resources. Most judges lack the background to deal with complicated project financings.

Controversies regarding TSI and security trusts may be subject to arbitration in accordance with international rules, by competent bilingual arbitrators. However, the enforcement of TSI must be made by a Venezuelan judge, following precise procedural steps set by law. In contrast, the trustee may sell the collateral and deliver the proceeds to the beneficiaries, without judicial intervention, according to a procedure established in the trust agreement.