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Simultaneous Break-Out Session

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that change. Chile has good pension rights, Peru is committed to introducing new legislation, and Argentina is beginning to provide for private pensions. In Colombia, you are also beginning to see pension rights. In the United States, on the other hand, most people who leave their job at the end of their career have some safety net from their employer. Quite frequently, that is not the case in Latin America.

QUESTION: I believe that with time and greater economic integration, employment laws in the Americas will become more and more similar. Are you in agreement with this?

ANSWER: I agree with you. I think as free trade grows in this hemisphere you are going to see a leveling of the laws. That was the experience in the European Community and I think that both the United States and Latin American will change to be a bit more protective of employees over time from the business point of view.

IV. SIMULTANEOUS BREAK-OUT SESSION

A. *Financing Latin American Business Ventures: U.S. and International Agencies*

FERNANDO PELAEZ²⁵

I am going to refer to the pragmatic and practical experiences of financing in Latin America, focusing on my experience in Venezuela. I will start by making some comments on the different sources of financing and basically giving you some history. In the 1970s, different sorts of financing available to develop industrial infrastructure in Latin America were extremely common. All of us were fully aware that capital was flowing to the main countries in Latin America to finance industrial development and the purchase of capital goods. This policy of financing without much analysis, coupled with the excess capital in the world in the 1970s due to oil prices, forced many Latin American countries to reschedule their debt. They did so mostly with banks and official institutions in America, Europe, and Asia, particularly Japan. Thus, in the 1980s, all of us in one way or another were heavily involved in the rescheduling of the public and private debt.

Nowadays, in Latin American countries, we are seeing that financing is once again flowing. However, this time there is a different approach. This new approach is great because it means that banks and official institutions are taking the experiences of the 1970s into consideration. Once again in Venezuela we are seeing financial institutions and government agencies take a very active role on project financing. This is a result of the continuous growth of our industries in some sectors — but note that financing comes

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with a strict criteria.

In order to finance in Latin American countries through the different mechanisms that exist, there are certain authorizations and limitations for lending. In the past, when we received the enormous flow of money in the 1970s, it was necessary to give authorizations, it was necessary to register those credit agreements, it was necessary to seek all kind of registrations, and nowadays that has changed dramatically. Basically, there is no need, at least in Venezuela, for getting special or previous approval for any sort of financing coming from abroad, or to register those credits before any competent authority, such as before the Central Bank. This is important because it gives more dynamic negotiation for all these loans and credit agreements.

Regarding exchange revelations, which also have an important effect on these negotiations and on financing from abroad, several Latin American countries have experienced exchange control revelations. Of course it is extremely important to analyze beforehand the different mechanisms that must be followed in order to obtain the authorizations for interest payments and for principle reimbursement. In some other countries there are no exchange revelations such as in Venezuela. In short, interest payments are made at the free rate of exchange without any need for prior authorization, and, of course, the reimbursement of principle is exactly the same. In our particular case, in the past when we were restructuring the public and the private debt we had a differential exchange system. The Central Bank took a preferential rate for the payment of interest and principle and in the last couple of years it was necessary to request authorization from the Central Bank to get those specific dollars which were at the preferential rate of exchange. But once again, that was just for a couple of years and now it is a free rate of exchange and there are no limitations. There really is convertibility.

Another important issue to take into consideration in this type of transaction is taxes. It is always important to analyze all the different implications that taxes will have in the whole transaction, especially now when this structure of financing is more complex. It is not just a simple credit agreement; it contains the purchase of equipment and materials, it contains the transfer of technology, technical assistance, and some other contracts. Simply focusing on the credit agreement in Venezuela, interest is taxed with a 5% flat withholding tax. There is no tax on reimbursement of principle. Each country in Latin America has a different taxation rate, so it is always important to analyze what the particular situation is in each country. Also, it is always important to analyze whether legislation in that particular country contemplates the possibility of obtaining an exoneration on taxes effecting that particular transaction. In the case of Venezuela, in the past such an exoneration was possible. Now it is not possible. Today in

Venezuela exemptions and exonerations must be general and not particular. So this 5% withholding tax applies to all interest paid to financial institutions lending from abroad.

Also, it is very important to analyze in all these cases the structure of the whole transaction. What we have been seeing more and more lately is the structure of price financing, which is basically used to develop certain priority sectors in the countries. For instance, in Venezuela, one priority sector, the petro-chemical sector, has been receiving substantial amounts of foreign funds through credits, basically PEMEX financing to develop the petro-chemical industry. About eight to ten years ago this was a sector reserved for the State. The government was committed to developing this sector by itself. Then they realized it was going to be very difficult for two main reasons: lack of financing and the need for technical assistance and foreign technology. So they decided to open this sector to foreign participation and private participation. There have been more than sixteen different joint ventures carried on by the Venezuelan government with private Venezuelan companies and foreign corporations for developing specific projects with the petro-chemical industry. Normally, this deal includes a package of contracts related to the specific project to be financed, such as purchasing equipment, engineering contracts, construction and turn key contracts, technical assistance and the transfer of technology agreements, and many other contracts depending on each particular project.

Another important issue is the security that a foreign bank wants to receive to guarantee the repayment of the loan. In this particular area, it is extremely important to pay attention to the different types of securities that foreign banks and government agencies can obtain in each one of the different countries. Why? Because you must take into consideration that all Latin American countries are based on civil law. It is a codified system and very often the securities that foreign banks and foreign agencies are interested in receiving do not exist in our legal system. Thus, they have to adapt what they have in mind to what is possible in accordance with our laws.

I just want to refer to one example. Recently we were involved and working for several months with a very large transaction in which a bank in Japan and the International Finance Corporation were involved and were interested in receiving a security interest on all the assets of the company, which under Venezuelan law is not possible. Thus, we had to sit down and discuss and analyze exactly what was the main interest that they had. Finally, we were able to define a package of securities in accordance with Venezuelan law that fitted their main interest to secure their loans, through pledges, mortgages, escrow accounts, and some other guarantees.

I think that it is also important to mention that in some of these transactions the government agencies (they are basically government agencies and in some cases banks) are interested in participating in the equity of the

local company. When that arises it is essential to go into a detailed analysis of the by-laws of the company, because part of the guarantees that the government agencies or the banks want is to have certain rights in the management and in the major decisions of the company. In other cases they subscribe the equity through the subscription of preferred shares, so it is extremely important to define all the rights of these preferred shares that will be redeemed in a period of time depending on the structure of the financing. Normally, the procedure that we follow in this type of transaction is that all the agreements that I have referred to briefly must be signed prior to or simultaneously with the execution of the credit agreement, because the lender must have the security that the whole package has been negotiated and can be put into effect simultaneously.

I think that the political and economic conditions in Latin America provide a fruitful opportunity for foreign direct participation and investment. However, many sources of project financing have either run dry or are reluctant to provide equity or debt participation, unless the particular project first receives the blessing of a U.S. or international development, financing, or guarantee institution. That is the result of the experience of the 1970s. All of these government agencies and all these international financial institutions have taken into consideration all the negative aspects we had and they suffered. As I mentioned before, I think that everyone suffered by the lack of responsibility in the negotiation and in the analysis of all the loans in the 1970s. Today, very restrictive rules have been enacted in order to provide funds. Nevertheless, I think that this has been for the good of not just the financial institutions but also for our own countries, because, first of all, all this new financing is now focused on the development of priority projects for our economies and very often related to economic programs. That is what I have to say regarding the different sources of financing. Thank you.

QUESTION AND ANSWER

QUESTION: Can you please explain exactly how a particular project is launched? I am especially interested in how a project will be financed.

ANSWER: As I mentioned, the package of contracts depends on the nature of each particular project. In some cases the government agencies and the financial institutions give the funds in order to carry on the feasibility studies of the project. This is normally the first step. The sponsors of the project receive these initial funds in order to pay for the feasibility studies, hiring advisors from the United States (or elsewhere), and local advisors. Once they have these feasibility studies they conclude the whole deal. Besides the contracts that I was referring to (basically the purchase of all the equipment and machinery, the turnkey contract for the construction of the plant, and the

technical assistance and the transfer of technology contracts) there are some other groups of agreements that come into effect.

Once the company starts up production and operations, one of the companies involved in the deal executes an agreement with the newly formed company in order to be the distributor of the products produced by the local company abroad. That is part of the structure of the whole deal and normally these distributorship agreements are executed for a number of years. That will guarantee that the repayment of the financing has been done. Why? Because part of the security that I was referring to, besides the securities of paying locally, like the pledges and mortgages, there is an escrow agreement opened offshore in order that the distributor pays the local company through these accounts. The banks are instructed to use the funds resulting from the distribution and selling of the products of the local company to pay interest and to keep the balance in the account in order to make the necessary reserves for the payment of the principle. On some other occasions, since these projects very often have a grace period of five years, they use the remainder of the funds as part of the working capital that is necessary for the local company to keep running the project. These contracts are very important.

Also, in some cases, there are other contracts that are signed by the sponsors of the project in order to guarantee the bank and financial institutions involved that in case something goes wrong they commit themselves to put additional funds into the company in order to cover any charges in the working capital. Our colleague from Argentina was referring to the guarantees that the Argentinean bank, Central Bank, or another bank gives in order to guarantee reimbursement. That might be the case in Argentina, but in many other countries as a result of the crisis that we had in the 1970s, government agencies do not grant any sort of guarantee, and that is the case in Venezuela.

That is why all these government lending agencies and the international financial institutions have worked out a very complex scheme of securities. Before, it was very easy, which led to the problems that we faced all over Latin America. They were lending without any analysis of the borrower simply because they were receiving a government guarantee. You know the rest of the story. Now that has changed dramatically, which is why they have worked to define all these types of agreements — to make certain that if something goes wrong, the sponsors would commit themselves to put the necessary cash into the company in order to make sure that the project will be completed.

In a case in which we were involved in recently, we worked much harder, but what we did as well was to define a guarantee. It was a very special sort of guarantee in which the lenders received as security the right to assign all of the contracts involved in the project. They wanted to have

the security that if something went wrong, they were going to be able to go out and propose these deals to other investors. Using these securities, they were going to be able to present the assignment of all the contracts that were necessary to implement the deal. Conversely, it is difficult to define these sort of transactions in five minutes, as they are extremely complex. To cite an example, I am going to give you a little bit more of the tale I had related previously so that you can evaluate this.

It took us about two-and-a-half years to finish all of the negotiations. The whole deal comprised thirty different agreements that we had to negotiate before the lending institutions were ready to sign the credit agreement. Together with this there were thirty agreements of all kinds. We negotiated the security agreements that were going to be implemented in Venezuela together with all the securities that were going to be implemented outside Venezuela. These were basically the escrow agreements and the security on all the cash that the company was going to be receiving. The structure that the Venezuelan petro-chemical industry has been following is quite interesting, because the equity of the company, up to a maximum of 30%, is subscribed by the Venezuelan State for the development of the petro-chemical industry. Twenty-one percent is subscribed by national investors, thus you have 51% local participation and 49% subscribed to by foreign investors. Out of that 49%, the financial institutions sometimes subscribe a maximum of 5% through preferred shares, as I previously mentioned, which are redeemed within the period that the loan must be repaid. The foreign corporations involved in the transactions normally are also the corporations that will be responsible for the technical assistance and the transfer of technology.

Normally, a group of these multinationals is responsible for the marketing and distribution of the products that will be manufactured by the new local corporation. This is more or less the structure of this type of deal and of the nationals involved in the project, in which there is normally one company responsible for what we call the local content. This can be referred to as the local engineering, the local equipment, and the local materials needed for the execution of the project. In addition, a lot of importance is given to the drafting and redrafting of the bylaws in order to avoid surprises at the end of the day. In general terms, those are the deals which we are now looking at in Latin America.

In Venezuela, this system has been successful in the development of the petro-chemical industry, and as our colleagues were saying from Ecuador and other countries, they are also opening the oil industry in their countries. Venezuela is doing exactly the same thing, but through different mechanisms. It is not privatizing the oil industry, but has decided instead to use strategic alliances through two different kinds of contracts called the operating contracts. These have been used to reactivate fields. This was a very long

procedure in order to get the government to approve new criteria. However, to some extent, they already existed because the same law that nationalized the oil industry in Venezuela in 1975 already contemplated the possibility that foreign corporations could be involved in the oil industry through these two different sort of contracts: the operating contracts and the strategic associations that are also called the strategic alliances. The difference is that the strategic associations and alliances refer to reserve sectors of the oil industry and must be approved by Congress.

The important thing is that we have the precedent. First, the Supreme Court issued an opinion stating that these contracts were valid and permitted in accordance with the law that nationalized the oil industry. Second, the Congress already approved the first three associations. One of these associations, which represents a project of around five billion dollars, was just signed by the Venezuelan oil industry, Exxon, Shell, and Mitsubishi. Furthermore, two other strategic associations already have been approved for the extraction of oil in the Orinoco belt, one with a Japanese company and another one with an American company.

The Venezuelan oil company Pedevesa already has signed more than eleven letters of intent. I am referring to these simply because these projects are going to be developed through project financing the day that Exxon, Mitsubishi, and Shell signed the agreement together with Lagoren. For the first association they said their intention was to raise around 60% of the cost of the project through project financing.

QUESTION: In oil exploration and exploitation contracts, who owns the oil, the companies who paid for the exploration contract of the State?

ANSWER: The oil will be the property of the company that will be exploring. That is to say, once the oil is extracted, it will be the property of the association and they will be responsible for its disposal. In opposition, those companies involved in the operating contracts that have been used to reactivate the inactive fields do not own the oil extracted, but they are compensated through a defined formula.

QUESTION: Who exactly will do the exploration for new oil reserves?

ANSWER: The exploration, extraction and commercialization will be carried on through the strategic associations.

QUESTION: Who do the lending corporations wishing to invest in Latin America look to for legal advice, lawyers in their home state or lawyers in the Latin American country?

ANSWER: Often lending institutions base their position on the opinion given by their counsel in New York, or Washington, or, in the one that I was involved in more recently, Tokyo. Sometimes the communication problems that result in order to finish the drafting of the documents is caused by the lack of understanding of the applicable regulations and local laws. For instance, the redrafting of the by-laws in the project that I was referring to

took us about seven months, because each time that we remitted the draft to New York it came back with a series of stipulations that, in accordance with Venezuelan law, were not acceptable or were covered in the other agreements. We worked with these documents for six months. However, it is important to always bear in mind that one must distinguish a problem based on whether it is a commercial position or a legal limitation.

ANSWER: This is very funny, but on the securities, they wanted to have a security entered by all means. We kept explaining that it was not possible for one reason or another. One day I merely said this was the end. We prepared a memorandum which came out to about thirty-five pages analyzing the whole Venezuelan system on securities. It was very good, because it was a deal that lasted almost two and a half years. Each time there was a new attorney involved in the deal, his first reaction was to obtain the security interest and all costs. The first thing we did was to send him a copy of the securities memo.

QUESTION: Is there any way to get around the problem that securities are not allowed in many Latin American countries, perhaps by using a pledge?

ANSWER: Going back to the security example, we said that it was not possible to have the security, but that it was possible to have it pledged. They agreed to have it pledged on the whole establishment. We said that it was not possible to have it pledged on the whole establishment, because we have one law that deals precisely with these types of pledges and it clearly defines what is and is not covered in the pledge. I remember the attorney said that he was sorry, but we already have one. I said that I was terribly sorry, but you may have a signed document and you may believe that you have it pledged on the whole establishment, but wherever you are going, if you have a need to execute this guarantee you are going to have a very unpleasant surprise. Then we went into these other documents and found out that what he had in mind as a guarantee was not such a guarantee.

QUESTION: Do the lenders get legal opinions on every contract that they enter into concerning the loan?

ANSWER: Yes, everything is based on legal opinions in these types of transactions. Usually you have one legal opinion for each one of the agreements, if it is an essential agreement. However, you also may have just one single legal opinion for the lender, comprising all of the agreements in which the local and the lenders support the repayment of the loan and the payment of the interest.

QUESTION: Approximately how long does it take to write legal opinions on each and every contract involved in a loan transaction?

ANSWER: I think that we normally, and, I suppose this is exactly your case in Argentina, spend no less than fifty hours discussing the draft of the opinion. Very often we are requested to give an opinion on things that are not what was stated and then you have to adapt that opinion to the specific

transaction and to the content of the local law. In most cases, one needs to introduce the necessary reserves, because we have reached the case where clients insist that we include in the opinion certain statements, thus we introduced reserves in our opinions. Sometimes they do not want to accept that fact, because lenders always want to receive what they call a clean opinion without any reserves. That is why it takes you a lot of time. Sometimes, and I should not say this, but sometimes the problem that we have is that the in-house of one of the companies involved has already signed the draft that was sent to them by the New York firm without reading it. Without transcribing that fact into its letterhead, the New York lawyer calls you and says: "You are giving me a lot of headaches, and I have already received the opinion signed by Mr. Y from Company X which is involved in the transaction."

