Venezuela: private sector debt swaps

Steven E Hendrix of Salas Toro & Hendrix, Caracas summarises the current provisions for the capitalisation of private sector debt as they relate to foreign debts held by non-Venezuelans.

The distinctions between capitalisation of private external debt, conversion of public external debt to foreign investment, and conversion of public external debt to domestic investment were reaffirmed in Decree 86 in March last year. Decree Number 86 also reconfirmed that earlier rules for the capitalisation of private external debt would be continued.

Capitalisation of private external debt in private companies was originally made possible by Decree 1200 in July 1986, and has since been amended by three further Decrees which set forth the requirements for the programme.

Government approval

Which agency approves the capitalisation in any given case depends on the registration of the company in which the debt is to be capitalised. If the company was originally registered for business with the Ministry of Mines and Hydrocarbons, then that agency would be the appropriate agency from which to solicit the capitalisation approval. Alternatively, if the company was registered with SIEX (the Superintendency of Foreign Investment), then SIEX would be the entity considering the capitalisation. No matter which agency of the government considers the capitalisation request as a matter of procedure, the substance of the law remains the same, since the authority for both the Ministry of Mines and SIEX is based on the same set of Decrees.

Prior to any debt/equity swap, the creditor should designate an attorney-in-fact to represent it before the debtor company and the relevant government agencies. The power of attorney must be made in accordance with Venezuelan law and executed before a public notary. If the power of attorney is being notarised by a foreign notary public, then the document must also be authenticated with the Venezuelan consul in the appropriate country. Further, the power of attorney must be in Spanish or translated into Spanish by a public interpreter in Venezuela.

Once the creditor has appointed its attorney-in-fact, the shareholders of the debtor company should meet to approve of the conversion in accordance with the by-laws of that company. Any approval by the shareholders must state that it is subject to the approval of the appropriate government agency. It is probably also a good idea to indicate how the corresponding article of the by-laws relating to the payment of capital and equity distribution will be stated once the conversion takes place.

The shareholders may only approve the conversion by means of an increase in the equity of the debtor company. Any increase must be in bolivars and all of the parties involved must agree on the exchange rate which will be used for the conversion.

As a matter of substantive law, holders of foreign currency obligations are able to transfer all or any part of those obligations into capital in the debtor company, provided that the holder first obtains the authorisation of the Ministry of Mines or SIEX along with the necessary registration of the conversion also with the appropriate agency.

In the event that the conversion results in the change of the debtor from a domestically-owned company (companies in which foreign equity is limited to not more than 19.99 per cent of the total equity) into a foreign-owned company (a company in which foreign ownership exceeds 48.99 per cent), in business sectors reserved for mixed companies (companies where foreign control ranges from 20 to 48.99 per cent of the total equity, the rest being held domestically), an arrangement must be reached for transformation into at least a mixed company within 15 years. If the debtor company happens to be in a business sector reserved for nationally-owned companies, then there must be some arrangement that the company will become nationally-owned within a period of 10 years. Any domestic participation contemplated by this capitalisation programme would require gradual progressive participation in ownership rather than a 100 per cent turn-over at a future date.

Rate of exchange

For those debts entered into prior to February 18, 1983, the rate of exchange for the conversion from debt (denominated in the foreign currency) to capital (denominated in bolivars) is determined by an Exchange Agreement between the National Executive and the Banco Central de Venezuela. This Exchange Agreement is designed particularly for the purposes of converting private sector, foreign-denominated debt into capital. Unfortunately, it is not entirely clear which exchange agreement will apply, since Exchange Agreement No 1 of March 13, 1989 repealed earlier Exchange Agreements. However, SIEX is aware of this problem.

For those debts entered into since February 18, 1983, the rate of exchange for the conversion is the free market rate used by the Banco Central de Venezuela as of the date of the conversion, assuming that the debt is for a cash amount in foreign currency. If, however, the debt is for a transaction of physical or tangible goods, then the rate used will be the customs duty assessment given to the particular debt.

Prior to granting any authorisation, the Ministry of Mines or SIEX will verify: the existence of the debt; the exact amount of the debt; and that the foreign currency or goods actually entered Venezuela. The actual application for the conversion should be made by the creditor.

To verify the debt, the Ministry of Mines or SIEX may accept audited financial statements. If the debt was previously recognised and registered with the Differential Exchange Office (known by the Spanish acronym RECADI), the Ministry of Mines or SIEX, as the case may be, will need only the voucher proving the registration: this alone is enough to obtain the verification of the Ministry of Mines or SIEX. However, it appears that prior RECADI registration is not a requirement for obtaining the Ministry of Mines or SIEX authorisation.

Decree 86 specifies that foreign-owned capital cannot be repatriated until after at least three years from the date of the appropriate authorisation. This will not apply after the three years have passed and will not apply to any domestically-owned company. In any event, after the three-year period, if a company is profitable, it can remit dividends in accordance with Decree 727 of January 1990. There are no exchange rate restrictions or specifications on the repatriation of the foreign direct investment resulting from the capitalisation.

Registered value

The Ministry of Mines or SIEX registration should always state the amount of the capitalised debt in freely convertible currency and the equivalent in bolivars at the exchange rate used. These amounts should be stated in order to comply with Article 96 of the Law of the Banco Central de Venezuela. This registered value serves two important purposes. First, it will be useful for the determination of any dividend payments. Second, it serves as documentation for later remittances of principal. However, this in no way fixes the value of the foreign investment in bolivars. Thus, there should not be any additional exchange risk problem, except for the devaluation of the bolivar.

It should be noted that it is possible to avoid the domestic ownership requirements. Conversions done in several business sectors are exempt from the domestic ownership requirements. These sectors include: tourism; agriculture; agro-industry; real estate construction; electronics; computer programming and biotechnology.

Under prior law, a number of accounting and tax considerations were of paramount importance in this process. Prior to March 1989, conversion of the debt could not be completed at a rate higher than Bs 14.5/US$1. At that time, it was usually more beneficial in some limited cases for multinational corporations to convert debt into bolivars at Bs 4.3/US$1 or Bs 7.50/US$1, since a conversion would produce a loss on the balance sheets which in turn would reduce the available income surplus for the company. Multinational companies, however, sometimes converted at the higher rate to record greater losses for tax purposes, since the loss is realised for tax purposes at the time the debt is converted into equity.

These considerations, however, have been changed by the new Exchange Agreement promulgated in March 1989 requiring that transactions be converted at free market rates of exchange. Now, conversions can be made at any rate from Bs 1 = US$1 up to the market rate (for example Bs 45 = US$1). Thus, there may be several tax considerations to take into account before engaging in this type of transaction.

Once the appropriate government agency approves the conversion of debt into equity, the debtor company should register the shareholders minutes at the Mercantile Registry.

All of the rules outlined above relate to foreign debts held by non-Venezuelans. Therefore, Venezuelan companies or individuals can purchase a foreign credit not registered by RECADI from a foreign creditor and make a debt-to-equity swap in the debtor company without notifying SIEX or the Ministry of Mines, or without the limit in the exchange rate for the capitalisation. If the foreign debt is registered with RECADI and the Venezuelan creditor and debtor are related parties, the Central Bank will sell official rate dollars to the debtor company pro rate up to the discounted value of the debt. Further, when the parties are related, the new creditor and debtor must notify the Central Bank of the assignment of the registered debt.

Of course, a Venezuelan individual or company can always incorporate offshore in order to receive the benefits of the debt-for-equity swap rules. □