Venezuela
VENEZUELA

The following is a review of recent legal and economic developments in Venezuela.

Public Sector Debt Renegotiation

On February 27, 1987, Venezuela agreed in principle with its creditors on the rescheduling of $21 billion of its foreign public sector debt. Venezuela renegotiated a prior agreement signed in New York a year ago. The Brazilian debt crisis may have facilitated this prompt agreement and its favorable terms. The rate of interest was reduced to 7½ % over LIBOR from 1½ % over LIBOR. Principal payments for 1987-1989 were reduced to $1.4 billion from $3.4 billion, and repayment was extended from 1997 to 1999. Pending final approval and execution of this agreement by its creditors, the Venezuelan government is considering floating a new bond issue in the international market.

Refinancing the Public Sector Debt

Negotiations for refinancing the already restructured public sector debt continue. The Venezuelan government would like to a further deferment of principal payments scheduled for 1987 and 1988 as well as a sharp reduction in the interest rate spread over LIBOR. Venezuela has retreated from its original position of no payments in 1987 and 1988, to offer $150 million for the first year and $250 million for the second; the banks’ negotiating committees are insisting upon at least $400 and $550 for the two years. Venezuela requested a reduction of the spread to ¾ % over LIBOR from the current LIBOR plus 1½ %.

Rescheduling Public Sector Foreign Debt

At the end of February, the Venezuelan government rescheduled its public sector foreign debt ($21.2 billion) on more favorable terms, reducing the interest rate from 1½ % over LIBOR to ¾ % over LIBOR and reducing the amounts to be repaid as principal during the next three years. No new loans were sought, and the public sector is reportedly current in its interest payments.
Coming only a year after the refinancing agreement which had scheduled the repayment of public sector debt over a twelve-year time frame, the new agreement extends the restructured term to fourteen years and decreases the principal payments fixed for the period 1987-89 from $3.35 billion to $1.35 billion payable over the same period ($250 million in 1987; $400 million in 1988; and $700 million in 1989).

Private Sector Debt

Until mid-1986, the Venezuelan government's program for assisting private sector foreign debtors with duly registered debt was designed to provide them with dollars for repayment of the principal amount of the debt at the pre-devaluation rate of 4.3 bolivars to the dollar over a period of five years. Many currency futures contracts were executed between private debtors and the Central Bank pursuant to this program, and the Central Bank began to make payments in accordance with the stipulated terms.

Faced with a reduction in foreign currency revenues and reserves due to the fall in oil prices in July of 1986, the Venezuelan government passed a law designed to replace its prior program. The law provided for repayment of the private debt with Venezuelan government bonds, payable over fifteen years at a maximum interest rate of five percent. Further, the preferential rate of exchange would be 7.5 bolivars to the dollar instead of 4.3 bolivars to the dollar. This law encountered considerable opposition among creditor banks and was repealed in September.

On December 8, 1987, legislation covering the system currently in effect (namely, the new Exchange Agreement No.2) was published. Its principal features are as follows:

a. the preferential rate of exchange for principal is 7.5 bolivars to the dollar (as of early March 1987, the free market rate was approximately 23 bolivars to the dollar); it is 7.5 bolivars to the dollar for interest due before December 9, 1986, and 14.5 bolivars to the dollar for interest due after that date;

b. the repayment period is extended to eight years from the first quarter of 1987;

c. principal is to be repaid in increasing portions over the eight-year term;

d. those debtors wishing to take advantage of the preferen-
tial rate of exchange must pay the Central Bank an insurance premium of 3 bolivars per dollar for principal, and up to 1.5 bolivars per dollar for interest (depending on the amount of interest for which a guaranteed exchange rate is desired). The premium can be paid all at once, or else over the eight-year period, in which case interest must be paid;

e. the interest rate for which dollars will be made available at the preferential rate of exchange is the lesser of 9% or 1 ¼% over three-month LIBOR;

f. as under the previous program, the debtors must sign a futures contract with the Central Bank;

g. the debtors must reach a restructuring agreement with their creditors before December 31, 1987;

h. dollars will be provided at the rate of 4.3 bolivars to the dollar in special cases where payment will be made immediately, and not over eight years, including payments for debts of up to $1 million, Decree 508 debt (contractors debts with the State, and debts insured by foreign governments) and payments for up to 10% of the outstanding debt, unless two or more quarterly payments have already been made.

Private Sector Foreign Debt

On March 19, 1987, in a landmark three-two decision which will affect the holdings of hundreds of other cases currently pending in the Venezuelan courts, the country's highest administrative court (the Corte Primera de lo Contencioso Administrativo) ruled that foreign debt of the private sector, which is more than forty-five days overdue as of February 18, 1983, is not entitled to registration by RECADI. The Venezuelan government took the position that such foreign debt is not legitimate, and therefore is not entitled to repayment at the then-prevailing preferential rate. However, most legal scholars claim that the Government’s position is not supported by legal principles. Instead, they contend the position arose because the international monetary reserves of Venezuela were very limited.

Factually, Hughes Services Venezuela, C.A., applied for registration of foreign debt amounting to $7,730,439.95. This amount was due prior to January 4, 1983. Thus the Venezuelan exchange control of February 18, 1983 should not have prevented registra-
tion. The RECADI Commission rejected this amount of registration on the grounds that such debt was not legitimate because it was overdue. The Commission, adopting an internal resolution never previously made public, ruled that debts more than forty-five days past due as of the date of imposition of exchange controls, are in the category of non-legitimate debts and are therefore not registerable.

The majority opinion imposes on the National Executive the duty to consider the availability of foreign exchange in setting criteria for recognition of debt entitled to the preferential treatment of repayment in dollars at the old exchange rate. Furthermore, the court upheld the discretionary authority of the Commission to adopt the internal rule which established the January 4, 1983, cut-off date. The court supported its decision by referring to the Code of Accounts of the Superintendent of Banks, which requires commercial banks to categorize as overdue obligations those more than forty-five days past due. The majority also refuted the contention that the debtor may have been entitled, as a matter of right, to repay its foreign debt at the same rate at which it was incurred. The majority opinion then stated that private sector entities in default on payment of admittedly overdue or open account obligations of February 18, 1983, could have acquired dollars at the Bs.4.3 rate prior to that date and should have done so. The court further stated that those debts less than forty-five days overdue had been registered as a matter of grace. The court found that serious circumstances required the denial of registration for overdue debts, since such registration would have been contrary to the economic interest of the country.

Restructuring the Debt

A sharp decline in the free market value of the bolivar resulted when the press published a confidential memorandum by the President of the Central Bank to the Minister of Finance. The memorandum disclosed that falling international reserves could reach a peril-point in operating reserves, currently estimated at some $3.7 billion necessitating selling part of the gold reserves or restructuring the already twice-restructured foreign debt. The report preceded the visit to Venezuela of Federal Reserve Chairman Paul Volcker, and the trip to Japan by the Minister of Finance to investigate the possibility of floating a bond issued in Japan or obtaining Japanese support for multilateral bank funding.
New opportunities for foreign investment will be created by debt-to-equity swap legislation under consideration by the Venezuelan government. Although debt capitalization will not be a panacea for the resolution of the foreign debt problem, its conversion into equity in selective cases will presumably accomplish the double objective of: (1) reducing debt and debt service charges, while at the same time; (2) attracting new foreign investment through the purchase of debt at a discount and conversion of the same into a new direct foreign investment base. Commonly referred to as Exchange Agreement No. 4, the proposed legislation would permit interested foreign investors to purchase either private or public sector foreign debt at a discount, convert the same into bolivars at the current-prevailing rate at the Central Bank, and register such bolivars as the investor’s direct foreign investment (DFI).

Each proposed debt/equity swap and the corresponding foreign investment would have to receive the prior approval of an interministerial commission composed of the Ministries of Finance and Development, the Central Bank, and the Superintendent of Foreign Investments (SIEX). The debt instrument, private or public, would be redeemed by the Central Bank at the Bs.14.4925 rate. The bolivars so generated would be registered as part of the DFI. Dividend remittances on such DFI would be limited during the first few years from registration of the same, as would repatriation of capital, but after stipulated periods of time, the normal foreign investment rules would apply. Priority would be given to debt-to-equity swaps contemplating investments in industries engaged in the production of goods for export or for substitution of imports, as well as in such fields as agriculture, tourism, transportation, chemicals and petrochemicals and other products considered to be of national interest.

**Debt to Equity Conversion Program**

The government of Venezuela has just introduced a debt-to-equity conversion program, under which foreign investors may be authorized to make investments in new and existing companies in Venezuela by purchasing and reselling outstanding public sector foreign debt to the Central Bank. The program is similar in many respects to the debt/equity programs currently functioning in Chile.
and Mexico.

**Export Transactions**

The Central Bank issued detailed regulations implementing its December Exchange Agreement No. 1 requirement that all exchange derived from exports of goods and services be sold to the Central Bank at the Bs.14.4925 rate. Exporters are required to enter into a foreign exchange sale contracted with the Central Bank, in the form published in the Official Gazette of February 11, 1987, specifying the details of the export transaction. The original regulations issued in January were modified in February to expand the concept of export services, the proceeds of which must be sold to the Central Bank.

Previously existing norms governing entities dealing in foreign exchange were modified, and tightening controls reducing the hours during which such exchange houses can operate. The new regulations purport to limit the role of exchange operators to that of mere intermediaries, prohibiting them from carrying out operations for their own account. One large exchange operator was closed by the Venezuelan government on charges that it was speculating in foreign exchange.

**Export Incentives**

To compensate exporters for the new obligation to sell their foreign exchange to the Central Bank at the Bs.14.4925 rate, instead of being free to retain such earnings or sell them at the free market rate, the Government has increased the export incentives payable in the form of export bonds by an average of five percentage points. Depending upon the degree of Added National Value (VAN), the export incentives are a percentage of FOB export price. For VANs of fifty to sixty-nine percent, the percentage was increased from eighteen to twenty-five percent. In addition, the Government has promised to expedite the issuance of such bonds and to increase funding for the Export Financing Fund.

**Venezuelan Export Legislation**

Legislation which could affect Venezuelan exports passed the U.S. House of Representatives by a 290-137 vote. The bill is designed to counter perceived unfair foreign trade practices and
mandate a response on the part of the Executive Branch to such practices. The bill contains provisions which would require revocation of the General System of Preferences (GSP) benefits for countries which are considered to have engaged in unfair trade practices. The bill also contains measures to strengthen protection of intellectual property rights, and makes the denial of certain workers' rights, such as a minimum wage requirement and right to collective bargaining, an unfair trade practice actionable under Section 301 of the Trade Act.

Discriminatory treatment of foreign investments, denial of access of U.S. goods to the foreign country's market by means of non-tariff barriers (e.g., prior licensing), piracy of U.S. patents, copyrights, and trademarks, targeting of U.S. markets for exports, granting of export subsidies either directly or through downstream subsidies (e.g., sale of state-supplied natural resources at concessionary prices) and other specified practices may give rise to mandatory or discretionary trade action by the United States against the offending country's products. Possible action includes revocation of GSP privileges, imposition of tariff and non-tariff barriers, or the application of countervailing duties. Venezuela could be vulnerable in some instances, and some of its leading non-traditional exports might be negatively impacted if the legislation receives Senate approval as well.

New Import Procedures

The Government has established new import procedures for 1987. The Ministry compiled statistics on imports into Venezuela during the years 1984, 1985 and the first nine months of 1986, by customs classifications, by importers-of-record, and by dollar amounts, so that the data shows precisely who imported how much (in quantity and in dollars) for what year. Based upon these statistics, provisional quotas (cupos) as to dollar amounts have been fixed for the first half of 1987 by industries, and these quotas in turn have been or will be distributed among the companies' members of a given industry. Overall allocations have been made, taking into account an assumed import budget of approximately $6 billion U.S. dollars for 1987. If an importer does not wish to draw against his quota, or time does not permit obtaining a conformidad before shipment of an essential product, the importer may import at the free market rate, subject always to the requirement that if a prior delegación is needed, such delegación has been obtained.
The question arises as to how new industries would obtain an import quota if they had not been in existence during the base years, or had been an infant industry at that time. According to the Ministry, if a new industry could show that it produced a product which would qualify as import substitution, the Ministry would reduce the old importer's quota by an amount corresponding to the previously imported product now available locally, and would redistribute the quota so recouped. Presumably, the new producer would receive some part of the dollar quota for his own imports of raw materials or components.

Foreign Exchange Rate and Controls for Imports

Exchange Agreement No. 1 of December 6, 1986, provides for an exchange rate of 14.5 bolivars to the dollar for most imports. Only a few items such as medicine and foods are entitled to a preferential rate of 7.5 bolivars to the dollar.

The foreign exchange budget for private sector imports for the whole of 1987 has been fixed at $6 billion. The Government has been reviewing the requests of the associations from different sectors of industry to allocate this total among them. Under rules established in May of 1986, importers who pay by letters of credit and import at a preferential rate of exchange were entitled to receive only twenty percent of the required foreign currency immediately. The remaining eighty percent was released when the goods arrived in Venezuela. Because of RECADI's delays in processing the applications for foreign exchange, the Central Bank decreed on January 27, 1987 that the amount of foreign currency to be released immediately will be fifty percent instead of twenty percent for importations under letters of credit opened before December 8, 1986, where the foreign currency request was presented to RECADI before February 5, 1987.

New Foreign Exchange Agreements

Private sector foreign debtors are slowly signing new foreign exchange agreements with the Central Bank, in accordance with the modified Exchange Agreement No. 2 of December 1986, replacing the old agreements issued under prior legislation. The old agreements guaranteed preferential dollars for debt repayment at Bs.4.3:$1. The new contracts provide for payment of principal over
a stretched-out term of eight years at the prevailing preferential dollar rate (currently Bs.7.5:$1), with initial amortizations of 2.375% per quarter during the first three years (1987-1989); 3.125% per quarter for the next two years (1990-1991); and 3.875% per quarter for the last three years. Debtors can lock themselves in at the current Bs.7.5:$1 preferential rate for principal and interest by signing a separate guaranty and trust agreement with the Central Bank and paying the corresponding premiums. The original time frame for signature of the trust agreement expired June 8, 1987, but was extended by the Central Bank until September 8, 1987. It is estimated that as of May 15, 1988, only 100 of the anticipated 500 agreements were signed.

Several companies made formal requests to the Central Bank to honor old foreign exchange contracts entered into at the Bs.4.3:$1 rate under old Convenio Cambiario No. 2, now revoked. There is some suggestion that they may initiate legal action against the Central Bank to force compliance with the original undertakings, or sue for damages for breach of contract.

Amendments to Exchange Control Agreement No. 3

Supplementing its December exchange control regulations, the Venezuelan government adopted clarifying amendments in February to Exchange Control Agreement No. 3, which provides:

(1) all foreign exchange from post-December 8, 1986 foreign investments, including the transfer of funds required to restore impaired capital pursuant to article 264 of the Venezuelan Commercial Code, must be sold to the Central Bank at the official Bs.14.4925 rate. Special instructions have been issued by the Central Bank to the commercial banks as to the procedures to be followed and documentation to be issued in this connection;

(2) all funds from post-December 8, 1986 foreign loans must also be sold to the Central Bank at the same Bs.14.4925 rate;

(3) the same requirements are applicable to funds entering Venezuela from foreign corporations created abroad but domiciled in Venezuela where such funds are destined for construction or the operation of installations and equipment;

(4) the Bs.14.4925 rate also applies to the registration of reinvestments or capital increases from earned surplus made after December 8, 1986.
Exchange Agreement No. 3 determined that the Bs.14.50 rate available for dividend remittances was applicable to earnings on post-December 8, 1986, foreign investments as well as to dividends remitted subsequent to December 8, 1986, but declared on old (pre-December 8, 1986) investment. The new regulations leave a question as to whether this preferential rate can be obtained for all dividends on old foreign investments or only for those dividends on earnings attributable to those fiscal years closing after December 8, 1986. The Bs.14.50 rate was also declared applicable to imports of technology and for payments made with respect to patent and trademark agreements registered with SIEX. Exchange Agreement No. 3 clarifies that with repatriation of capital, the Bs.14.50 rate is only applicable to foreign investments made subsequent to December 8, 1986; pre-December 8, 1986 foreign investments can only be repatriated at the free-market rate, although dividends with respect to the same are entitled to the Bs.14.50 rate, as indicated above.

The new regulations provide that the preferential Bs.14.50 rate can only be obtained from the Central Bank after the prior certification of the amount entitled to Bs.14.50 exchange by SIEX. An authorization for obtaining exchange will be issued by SIEX only after ascertaining whether the investment, agreement, or loan has been properly registered and that the amount of exchange applied for is correct. Presumably, the calculation of dividends permitted by Venezuela's regulations to Andean Pact Decision 24 can be readily calculated, but delays may be inherent in any verification of royalties based upon net sales of trademark or patent licenses. No dividend calculations will be made until the investor has updated his direct foreign investment base at SIEX.

**Interest Rates**

The interest rate for most commercial bank loans has been fixed at thirteen percent since October 1985. This rate appears unrealistically low, especially where a higher rate of inflation is expected this year. The official rate for 1986 was 11.5%. The anticipated increase in inflation is expected largely because of the higher cost of imports resulting from the December 1986 change in the preferential rate from the 7.5 bolivars to the dollar to 14.5 bolivars to the dollar.
Suspension of a Currency Dealer

Italcambio, a large local currency dealer, did not have its license renewed, allegedly because it used loans from the savings funds of state oil operating companies in order to speculate in foreign currency.

Rules Tightening Currency Operations

The Central Bank tightened the rules governing the operations of currency dealers, prohibiting them, for example, from dealing between themselves in foreign currency. The Venezuelan legislation is more liberal than comparable Mexican and Chilean rules, although no regulations have yet been issued, nor is there any experience factor how the conversion of foreign debt into new investments will work in practice.

There are no limits on the number of transactions which can be effected in a given month, but approval of operations will be made by the interministerial commission on a case-by-case basis. The most important feature of the new legislation is that it encourages new foreign investment and capital repatriation, providing business opportunities for investors as well as anticipated savings to the country in debt service. The Chilean experience to date indicates that such transactions are not inflationary, while in Mexico the program has had the effect of reversing capital outflow. Any conversion of foreign obligations to new investments through debt/equity swaps is predicated upon the sale of the foreign debt instrument at a discount, which reportedly ranges as high as ninety percent for Bolivia, to forty percent for Mexico and twenty percent for Colombia. Market forces have yet to fix the discount for Venezuelan paper which will be sufficiently attractive to investors.

Reserve Requirement

In an attempt to stabilize the free market exchange rate and reduce speculation through future contracts, the Central Bank established a 200% reserve requirement for commercial bank loans to nonresidents and foreign companies not domiciled in Venezuela. Also, on loans effected by Venezuelan banks through branches or agencies abroad, there is the same requirement. In addition, banks are forbidden, except as collection agents, to sell foreign currency to nonresident corporations.
**Reporting Requirement**

Banks must report to the Central Bank, on a monthly basis, any loans granted to companies classified as "foreign-controlled corporations" under Andean Pact foreign investments rules, i.e., companies more than forty-nine percent owned by non-Venezuelans.

**Preferential Dividend Rates**

The Central Bank clarified the interpretation of Exchange Agreement No. 3, making it clear that dividends entitled to the preferential Bs.14.5:$1 rate would only be those dividends attributable to fiscal years closing subsequent to the effective date of new Exchange Control Agreement No. 1, namely, December 8, 1986. The resolution also provides that the Bs.14.5 rate is applicable only to technology, trademark and patent fees payable after December 8, 1986.

**Sale of Dollar Bills or Other Foreign Currency Abroad**

Pursuant to Central Bank resolution published April 8, 1987 commercial banks and exchange houses which wish to send dollar bills or other foreign currency must first offer them for sale to the Central Bank at the exchange rate contemplated in Exchange Agreement No. 1. If the Central Bank does not exercise its first option to purchase the bills, the banks and exchange houses may export them, but must sell the exchange amount realized from such sales to the Venezuelan customs authorities who provide export permits for such transactions.

**Andean Pact**

The Andean Pact was signed in 1969. Its current members are Venezuela, Colombia, Ecuador, Peru and Bolivia. These countries have formed an Andean Common Market for the exchange of goods and the efficient distribution of production among its members.

The Pact has been criticized by officials of some member countries in recent years, particularly Ecuador, as having not achieved its aims, and even as being counterproductive. Decision 24 of the Andean Pact Commission, which restricts foreign invest-
ment in the member countries, has been viewed as unnecessarily discouraging foreign investment. Representatives of the member countries reached agreement in January 1987 on major amendments to the Andean Pact after years of discussion. These amendments provide for more flexible systems of industrial integration, and for representation before the Andean Pact authorities of workers and employers from each member country.

The amendments to the Pact were due to be signed formally in Quito on February 16, 1987. Venezuela, however, requested at the last moment that the signing be postponed to consult more fully with Venezuelan employers' and workers' organizations. Fedecamaras, the chief employers' organization, viewed the amendments as potentially harmful to Venezuelan industry by exacerbating local competition. Fedecamaras has proposed that trade barriers not be removed for items which all member countries presently produce.

Proposed Adherence to the Protocolo Modificatorio

Discussions continue with respect to Venezuela's proposed adherence to the Protocolo Modificatorio, a modification of the Andean Pact agreements. The Venezuelan Business Association's umbrella organization, Fedecamaras, has protested that the private sector was not permitted to participate and was not consulted with respect to the negotiations carried out during the past three years. Another Fedecamaras concern is the possible inundation of Venezuelan markets by products manufactured in other Pact countries, primarily Columbia and Ecuador, through the elimination or sharp curtailment of the Lists of Exceptions where one country limits the duty-free entry of certain products from other countries.

The new Protocolo would modify Decision 24, regulating foreign investments and technology transfer, liberalizing it along the lines already adopted in Venezuela’s Decree 1200 of last year. The sectorial development programs promulgated in certain decisions (e.g., the automobile industry) would be scrapped, due to noncompliance. The Protocolo would also incorporate into the basic Andean Pact Agreement such existing institutions as the Andean Pact Tribunal, and establish a mechanism for fixing norms of origin, a controversial subject unresolved since the creation of the Pact in 1970.
Opposition to Proposito Modificatorio

There is considerable opposition in the Venezuelan business community to the proposed modifications to the Andean Pact. The umbrella business organization, Fedecamaras, has protested that its officers and directors were not consulted at any phase of the negotiations conducted by the Venezuelan Institute of Foreign Trade. The controversy centers not so much on proposed changes in the rules governing foreign investments, but on changes which would, in the perception of Fedecamaras members, hurt Venezuelan industry through the liberalization, *vis-à-vis* other Pact countries, of Venezuelan protective tariff and restrictive import practices.

Recognition of Exchange Losses

The Venezuelan Income Tax Administration has indicated its opinion that exchange losses will only be recognized for tax purposes in the year in which the dollar (or other foreign currency) obligation is paid. It is not clear whether the position of "no taxation without realization" will be equally applicable where Venezuelan taxpayers hold dollar assets which have appreciated in value when measured in bolivars.

Income Tax on Petroleum Exporters

Petroleum exporters pay Venezuelan income taxes on realized values plus a percentage determined annually by joint resolution of the Ministries of Finance and of Energy and Mines. To compensate PDVSA's affiliates for the loss of revenue resulting from the decline in oil prices during 1986, the markup over realized price had been reduced from twenty-five percent during the years 1983 through 1985 to twenty percent. By resolution published in May, this markup was reduced to seventeen percent for the year 1987.

General Income Tax Withholding Regulations

New general income tax withholding regulations, contained in Decree 1506, were issued April 24, 1987, replacing a series of prior decrees and combining them in a single text. Certain additional withholding requirements were added, the most significant of which was the provision which issues the certificates as to price,
quantity and quality regarding imports qualifying for preferential dollars. The withholding, is twelve percent of the deemed net of thirty percent, resulting in an effective withholding tax of 3.6% of the gross payment. The new regulations went into effect May 1.

New Venezuelan Income Tax Regulations

The new Venezuelan income tax law went into effect for most taxpayers as of January 1, 1987, as did the new stamp tax law. New regulations regarding withholding on salaries and wages have been announced, simplifying prior withholding tax tables but requiring payment to the Government of amounts withheld (or required to be withheld) within two days following the date of payment of the salary. Failure to make timely payment to the Government can result in fines and disallowance of the salary expense. The two-day time period has been protested by business as being unrealistic.

Income Tax Legislation

The new Venezuelan income tax law, which was promulgated last year and which became effective as of January 1, 1987 for calendar year taxpayers, provides for obligatory consolidation for tax purposes for those taxpayers deemed to be engaged in the same line of business and under common control. To date, no regulations have been issued regarding tax consolidation requirements or regarding what is meant by such terms as "same line of business" or "common control." The current draft would subject to the tax consolidation requirement those companies engaged in the production or exchange of the same product or service and which are controlled directly or indirectly by a shareholder or shareholder group owning fifty percent or more of the voting shares, or majority voting power, or which otherwise have the dominant control of the companies. A single shareholder, for this purpose, includes individuals related by blood or by marriage within certain defined degrees of relationship (e.g., great-grandparents and great-grandchildren constitute a single shareholder, as do a spouse and in-laws to the second degree of affinity). Difficulties are anticipated in trying to ascertain, for example, whether the production by affiliated companies of such diverse items as plastic containers (bottles) and dissimilar plastic products (seat covers, for example) would be considered by the tax authorities to be the exploitation of the same
product (plastics), although logic would appear to support deconsolidation on the grounds that containers and seat covers are unrelated products.

New comprehensive withholding tax regulations are presently being drafted, incorporating and coordinating many of the provisions of existing regulations. The new regulations would specifically provide for a twelve percent withholding tax on payments to be made to price, quantity and quality certification firms referred to in Article 63 of the Income Tax Law and required under Venezuelan import regulations. Although the overall Tax Code, which went into effect in 1983, would theoretically permit a gross-up so that the fee paid to such firms could be net of tax, the current arrangement with the Venezuelan government establishes a ceiling on such fees.

*Foreign Investment*

Decree 1200 of July 16, 1986, amended and liberalized the foreign investment laws of Venezuela in many ways. First, majority foreign-owned Venezuelan companies need no longer become transformed into majority Venezuelan-owned companies except to operate in certain reserved areas or to enjoy the Andean Pact tariff privileges. Second, the authorized annual dividend remittance was increased to twenty percent over LIBOR. Next, foreign investments fulfilling certain requirements (for example, those using 40% or more of local capital) no longer need prior authorization by the Superintendency of Foreign Investments (SIEX); instead, they need only be registered subsequently.

Electronic, informatics and biotechnical investments are excluded from foreign investment controls, as are those involving a joint venture with the Venezuelan state, and those which export more than sixty percent of their production. The Finance Ministry may authorize a foreign investment of up to forty-nine percent in areas (such as public services, communications and professional services) reserved to national companies (i.e., those having a foreign investment of less than twenty percent). Further, some areas (such as internal distribution of goods) may now have a foreign investment of up to forty-nine percent without special approval. Foreign investors may acquire a local company via a capital increase, unless it operates in an area reserved to national companies.
Technological transfer contracts containing certain clauses required by the Decree, excluding certain restrictive clauses, and providing for a royalty of not more than five percent of net sales or three percent of net profits, as well as distribution contracts no longer require prior approval. Also technological transfers may now be capitalized as a foreign investment. Another change provides that royalties may be paid by a subsidiary to a parent company in certain cases. Two percent of the amounts paid annually under technological transfer contracts must be paid to a fund for the scientific and technological development and investigation of the country or the company. No prior authorization is required for the transfer of shares between two foreign investors. The acquisition need only be registered subsequently with SIEX.

Lastly, another important change was made later by Exchange Agreement No. 1, and more recently by Exchange Agreement No. 3 of February 11, 1987. The rate of exchange at which foreign investors must sell their foreign currency to the Central Bank when making the investment, and that at which they obtain foreign exchange when remitting dividends or capital abroad is fixed at 14.5 bolivars to the dollar. The same rate is fixed for payments of royalties for technology, patents or trademarks.

RECADI's Demise

RECADI's demise was officially announced by Decree 1544, published May 6, 1987. This much criticized agency ceased activities June 15, 1987. The foreign debt functions still existing will be assumed by the Ministry of Finance's Dirección General Sectorial de Finanzas Públicas. RECADI's functions relating to the allocation of preferential dollars for imports will be assumed by a newly-created section of the Ministry of Finance entitled the Dirección General Sectorial de Divisas para Importaciones. In addition, a new interministerial commission, entitled the Comision de Importaciones, was created to fix criteria for the granting of preferential exchange for both the private and public sectors. It determines the policies and priorities applicable in the issuance of authorizations for preferential exchange requested by the private sector.

Price Controls

Since November 1984, there exists a dual price-control system: one for prime necessity goods which cannot be increased without
the approval of a joint Government/employer-worker commission (Conacopresa); and another for nonessential goods, where the price increase requires notification of the Ministry of Development sixty days in advance.

In February 1987, the government, in response to alleged excessive requests for price increases, and hoarding of and speculation in goods following the economic measures of December 6, 1986, introduced requirements for those companies increasing prices for non-essential goods. Further, by Resolution 0488, the Ministry of Development added a large range of goods to the prime necessity list, including: construction materials; agricultural supplies; domestic electrical appliances; spare parts; textiles, shoe materials, publishing industry supplies; medical and dental instruments; and motorcycles.

**Compensatory Bonus Plan**

On the eve of May 1, 1987, President Lusinchi announced across-the-board wage increases, on a sliding scale, for all workers and employees earning less than Bs.20,000.01 per month. Titled a compensatory bonus and designed to offset increases in the cost of living, persons earning a base salary of up to Bs.2,100 per month will receive a thirty percent increase; those in the Bs.2,100.01 to Bs.6,100 bracket receive a twenty-five percent increase; and those earning more than Bs.6,100, but not in excess of Bs.20,000 per month, are entitled to a twenty percent salary increase. Salary and wage adjustments go into effect on May 1, 1987. In addition, the decree contains a 120-day ban on dismissing employees.

The decree specifically provides that the compensatory bonus does not form part of the salary for purposes of calculating year-end obligatory profit sharing or the determination of severance pay. However, we are of the opinion that the general provisions and regulations of the Labor Code override this article, and that the courts will hold that additional payments constitute part of the salary. Meanwhile, a lawsuit was filed in the Venezuelan Supreme Court to ascertain whether the bonus forms part of the salary.

The new wage increase decree raises numerous legal problems. By expressly providing that the compensatory bonus does not constitute part of salary, it is not taken into account in calculating profit sharing, severance pay and other benefits calculated on the basis of salary. It leaves unanswered the income tax treatment to
be accorded to the bonus. The new decree further provides that in calculating the amount of bonus payable, any salary raises granted since the first of the year or to take effect during the current year should be offset against the amount of the bonus.

**New Chief Justice**

Dr. Rene de Sola, a longtime magistrate of the Venezuelan Supreme Court, was elected Chief Justice.

**Proven Petroleum Reserves**

Venezuela doubled its estimates of proven petroleum reserves to fifty-five billion barrels — about twice those of the United States. Recent figures indicate that Venezuela ranks as the No. 2 oil exporter to the United States, exporting an average of about 850,000 barrels of crude oil and petroleum products per day.

**Eighteenth Annual Conference of the Council of the America's**

The Council of the America's 18th Annual Washington Conference, held in May was attended by over 200 leading businessmen, including representatives of the Venezuelan private sector. Discussions included U.S. trade policies with respect to Latin America, the debt problem, the protection of intellectual property rights, and the business climate in Brazil and Mexico.

**New Code of Civil Procedure**

The effective date of the new Code of Civil Procedure, already postponed from last September to March 15, 1987, may be postponed again, in view of the fact that the Venezuelan Congress has modified four articles of the new Code.

Below are translations of Decree No. 1,521 and Exchange Agreement No. 4, which contain the current regulations governing the debt/equity program.

*Exchange Agreement No. 4 Ministry of Finance - Central Bank of Venezuela*

The Central Bank of Venezuela, represented by its President, Hernan Anzola, authorized as follows:
First: The capitalization of foreign credits shall be effected at the maximum rate of exchange of Bs.14.4925 per dollar of the United States of America. In the case of private foreign debt registered in the Office of Differential Exchange Regulations (RECADI), the amount capitalized shall be deducted from the net balance of the respective debtor enterprise.

Second: In cases of the conversion of external public debt into investment, the Central Bank of Venezuela shall purchase or exchange the credits representing said debt at the rate of exchange of Bs.14.4925 per dollar of the United States of America.

Third: In the case of the conversion of external public debt into foreign investment, the Central Bank of Venezuela shall issue a verification of the purchase or exchange of credits, which shall be presented by the interested party to the competent national agency, for purposes of registering the investment in question.

Fourth: This Agreement shall enter into effect on the date of its publication in the Official Gazette of the Republic of Venezuela.

Rules for the Conversion of Foreign Debt into Investment

1. Chapter I - General Provisions

Article 1. The conversion of external debt into investment shall be carried out in accordance with this Decree, in the resolutions which the Finance Ministry shall issue in such regard and in the corresponding Exchange Agreements entered into between the National Executive and the Central Bank of Venezuela.

Article 2. The conversion of external debt into investment may be effected by means of:

(a) The capitalization of external credits in the debtor enterprises;

(b) The conversion of external public debt into foreign investment; and

(c) The conversion of external public debt into national investment.

2. Capitalization of External Credits

Article 3. The capitalization of external credits in debtor enterprises may be effected at the maximum rate of exchange established by the National Executive and the Central Bank of
3. Chapter III - Conversion of External Public Debt into Foreign Investment

Article 4. A Commission is hereby created made up of the Minister of Finance, the Minister of Development and the President of the Central Bank of Venezuela.

The Commission shall have as its purpose the authorization of the conversion of external public debt into foreign investment, based on the reports submitted by the Executive Secretary.

In the case of foreign investments in sectors which are subject to the jurisdiction of national agencies other than the Office of the Superintendent of Foreign Investments, such agencies shall submit the corresponding reports through the Executive Secretary of the Commission.

The Commission shall establish the time periods in which the authorized foreign investments may be made.

The registration of the foreign investments referred to in this article shall be effected by the corresponding competent national agency based on the authorization issued by the above mentioned Commission, once the new enterprise is organized or the capital of the enterprise receiving the investment is increased or restored.

Article 5. When the conversion of the external public debt into foreign investment entails the transformation of the recipient enterprise into a foreign or mixed enterprise, such enterprise only shall be transformed when it desires to benefit from the advantages derived from the Program of Liberation of the Cartagena Accord, except as otherwise provided by the Commission referred to in the preceding article.

Article 6. In order to obtain authorization the interested parties must agree not to remit abroad, with respect to the part of the foreign investments derived from the conversion of external public debt for a period of three (3) years from the date of registration, the dividends or benefits corresponding to the shares, quotas, participations or rights, in an amount which exceeds ten percent (10%) annually of the respective foreign investments. The amounts of tax paid by the investor in respect of these benefits shall not be computed for such purpose.

After the expiration of the above-mentioned time period, the
foreign investors may make remittances of dividends or benefits under the terms and conditions provided in Decree No. 1,200.

Article 7. In the event of the liquidation of the enterprise receiving, the foreign investment, and prior to the expiration of the periods indicated in Article 13 for the re-exportation of the invested capital, the capital derived from the liquidation only may be used by the foreign investor for the following purposes:

(a) Investment in another enterprise, in which case for the purposes of calculating the time periods for the remittance of profits and the re-exportation of invested capital, the date of the first investment realized shall be taken as the base.

(b) Acquisition of Development Portfolio Securities.

Article 8. The Registration of Direct Foreign Investment shall indicate the par value of the external debt substituted, in freely convertible foreign currency and, for the sole purpose of complying with the provisions of Article 96 of the Law of the Central Bank of Venezuela, shall include the equivalent in bolivars of the registered investment, at the rate of exchange established in the Exchange Agreements entered into between the National Executive and the Central Bank of Venezuela.

Article 9. In cases of conversion of external public debt into foreign investment, the sale of shares, participation or rights of the foreign investor must be notified to the respective competent national agency within the thirty (30) calendar days following the date of the operation.

After the sale is effected the corresponding registration shall be updated and there shall be applied to the new foreign investor, if applicable, the covenants with respect to remittance of dividends or benefits and re-exportation of capital, undertaken pursuant to the provisions of Articles 6 and 13 of this Decree, taking as the base the date of registration of the first investment.

The sale of shares, participation or rights from one foreign investor to another foreign investor shall not be considered as a re-exportation of capital.

Article 10. The Commission referred to in Article 4 may authorize conversions of external public debt into foreign investment. This investment is directed to the substitution of imports, the export of goods, the avoidance of bankruptcy of enterprises, or the following sectors:
(a) Agriculture;
(b) Agroindustry;
(c) Construction;
(d) Construction of infrastructure for tourist activity, as well as the rendering of services connected therewith;
(e) Construction of social interest housing;
(f) Services of air, land, maritime and river transport within the country, or connected activities;
(g) Production of capital goods;
(h) Manufacture of chemical and petrochemical products;
(i) Electronics and informatics;
(j) Biotechnology;
(k) Aluminum and the transformation thereof.

Article 11. Once the conversion of external public debt into foreign investment is authorized, the Central Bank of Venezuela shall purchase from the investor credits representing external public debt, in order to provide the investor with the bolivars necessary to make the authorized investment.

The Central Bank of Venezuela may establish mechanisms for the exchange of credits representing external public debt for instruments of the internal public debt, instead of the purchase contemplated in the heading of this Article.

Article 12. The Central Bank of Venezuela shall purchase or exchange the foreign credits mentioned in the preceding article at par value or at such discount as may be established for such purpose by the Commission referred to in Article 4. Interest accrued and unpaid to the date of purchase or exchange shall be included in the operation at par value.

In the Exchange Agreements entered into between the National Executive and the Central Bank of Venezuela, the rate of exchange applicable to these acquisitions shall be established.

Article 13. In order to obtain the authorization contemplated in Article 4, the interested parties must agree not to re-export the capital derived from the conversion of the external public debt into foreign investment during the first five (5) years following the date of registration of the investment. In addition, they must agree that, during the eight (8) subsequent years, the maximum percentage of
re-exportation of capital shall be 12.5% annually, on the understand-
ing that the amounts not re-exported during one of these years shall be accumulated with those of the following years.

After the expiration of thirteen (13) years from the date of registration of the foreign investment, the re-exportation of capital may be done without any limitation.

Article 14. The Commission may condition the granting of the authorization to convert external public debt into foreign investment, upon the condition that the cost of the imported component required for the installation or expansion of the respective projects be covered by external sources of financing.

4. Chapter IV - Conversion of External Public Debt into National Investment

Article 15. The Central Bank of Venezuela may acquire from the State enterprises credits representing external public debt, by purchase with payment in national currency or exchange for instruments of internal public debt, on the terms and conditions to be established by the Board of Directors of said Institute.

Article 16. In the Exchange Agreements subscribed for such purpose between the National Executive and the Central Bank of Venezuela, the rate of exchange applicable to the operations indicated in the preceding article shall be established.

5. Chapter V - Final Provisions

Article 17. For the purposes of this Decree, the competent national agency means the Office of the Superintendent of Foreign Investments and the agencies indicated in Article 1, Sole Paragraph, of Decree No. 1,200. In addition, external credit shall mean that contracted in freely convertible foreign currency.

Article 18. The credits representing external public debt that are acquired by the Central Bank of Venezuela in accordance with the provisions of this Decree shall be converted into internal debt under financial conditions equal or better for the debtor entity, as determined in each case by the Ministry of Finance and the Central Bank of Venezuela, in accordance with the provisions of the second paragraph of Article 64 of the Organic Law of Public Credit.
Article 19. The Minister of Finance shall issue such resolutions as may be necessary for the application of this Decree and is authorized to enter into such Exchange Agreements with the Central Bank of Venezuela as may be appropriate.

Article 20. This Decree shall enter into effect on the date of its publication in the Official Gazette of the Republic of Venezuela. Promulgated in Caracas, on the 14th day of the month of April, 1987 year 176 of Independence and 129 of the Federation.

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