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Venezuela: Certain Legal Considerations for Doing Business

Robert J. Radway*

BACKGROUND AND INTRODUCTION

A. ANDEAN PACT AND DECISION 24

IN ORDER TO FOSTER the development of large-scale industries in Latin America and correspondingly adequate levels of production, the Latin American Free Trade Association¹ (LAFTA) was created by seven South American countries and Mexico at Montevideo, Uruguay in 1960. The Treaty of Montevideo established a free trade area in the combined territories of the contracting parties to be fully operational within 12 years. The Preamble states that the member governments were:

Persuaded that the expansion of present national markets, through the gradual elimination of barriers to intra-regional trade, is a prerequisite if the Latin American countries are to accelerate their economic development process in such a way as to ensure a higher level of living for their peoples. . . .²

Difficulties continued to hamper the progress of Latin American economic integration and to decrease the prospects of achieving a Latin American Common Market by 1985 as agreed by the presidents of the hemisphere republics at Punta del Este, Uruguay in April of 1967.³

These difficulties and anxieties about disparities between the more developed big three (Argentina, Brazil, Mexico) and small-

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¹ Treaty Establishing a Free Trade Area and Instituting the Latin American Free Trade Association (Montivideo Treaty) Feb. 18, 1960, 30 U.N. ECOSOC Supp. 4 at 32, U.N. Doc. E/3333 E/CN 12/AC.45/13/Rev. 1 (1960); *see also*, Inter-American Institute of International Legal Studies, note 2 *infra*.

² Inter-American Institute of International Legal Studies, Instruments Relating to the Economic Integration of Latin America, 207 ff. (English ed. Oceana Publications, Inc. 1968).

³ *Id.* at x.

er LAFTA nations led to the proposition that creation of an economic bloc was necessary to permit the latter LAFTA members to participate more equitably in the benefits of the development and integration movement with the former big three. Thus, the Agreement of Cartagena⁴ was signed on May 26, 1969, by five LAFTA nations (Bolivia, Chile, Colombia, Ecuador and Peru), thereby creating an Andean Common Market for the subregion. Mutual interests of the five countries included a common language, contiguity with the Andes mountains, and a professed desire to accelerate the economic integration and development of the area. Venezuela acceded to the Andean Pact on February 13, 1973, by signing the Consensus of Lima.⁵ The Market (ANCOM) is governed by a Commission which issues rulings on matters brought before it relating to the implementation of the Pact and the establishment of the Common Market.

ANCOM places emphasis on trade liberalization, including the elimination of trade barriers among the member countries by the end of 1980 (end of 1985 for relatively less developed Bolivia and Ecuador which receive preferential treatment throughout the program). To this end, a tariff schedule of nearly 6000 items has been established, providing for the ultimate total elimination of tariffs on intra-regional trade by means of annual reductions of 10 percent from January 1, 1971, through December 31, 1980, based upon the lowest preintegration tariff rate for the items in the nonpreference countries. The ANCOM agreement provides limited temporary tariff exemptions up to 15 years permitting certain classes of goods to forego tariff advantages. A common external tariff has been planned for application by 1980 on imports from outside the subregion.

Nearly one-third of the items on the schedule are reserved for the Sectoral Programs of Industrial Development, which is an

⁴ The Treaty of Cartagena is an agreement of Andean Subregional Integration. For text of the Treaty in English see 8 INT'L LEGAL MAT'LS 910 (1969); see generally Ebb, *Transfers of Foreign Technology in Latin America: The Birth of Antitrust Law*, 43 FORDHAM L. REV. 719 (1974); Furnish & Atkin, *Andean Group's Program for Industrial Development of the Metalworking Sector: Integration with Due and Deliberate SPID*, 7 LAW. AM. 29 (1975); Note, *Technology Trade and the Law: A Preliminary Exploration*, 6 L. & POL. INT'L BUS. 85 (1974); Schill, *The Mexican and Andean Investment Codes: An Overview and Comparison*, 6 L. & POL. INT'L BUS. 437 (1974); Lisocki, *The Andean Investment Code*, 49 NOTRE DAME L. REV. 317 (1973); Schliesser, *Recent Developments in Latin American Foreign Investment Laws*, 7 INT'L LAW. 357 (1973); Perenzin, *Multi-national Companies under the Andean Pact: A Sweetener for Foreign Investors*, 7 INT'L LAW. 396 (1973).

⁵ The Consensus of Lima is the final act of the negotiations on the entry of Venezuela into the Cartagena Agreement. (Lima, Peru, Feb. 13, 1973) 12 ILM 344 (1973).

attempt to coordinate industrial development planning. These Sectoral Programs are designed to encourage specialization and economies of scale and thereby broaden the range of products which can be manufactured efficiently in ANCOM countries. A corollary objective is to coordinate investment by the mechanism of the Sectoral Programs, wherein given manufacturing operations are assigned to specific countries. The principal determinants of plant assignment are existing specialization in the individual countries, relative availability of relevant natural resources, and comparative advantages in the traditional economic sense. The Sectoral Programs were to have been negotiated before the end of 1973; however, the deadline was extended until the end of 1975 for certain major industries. The first Sectoral Program negotiated concerned the metalworking industry, with the exception of automotive and steel operations, and was approved on August 20, 1972.⁶ For purposes of trade liberalization benefits, certificates of origin are issued for identification of all items manufactured within the six countries.

Together with trade liberalization and the coordinated planning of industrial development, ANCOM attempts to harmonize the economic policies of the members. The most significant development in the implementation of this objective is the widely discussed Decision Number 24 of the Commission, the ANCOM Foreign Investment Code.⁷ The Code was approved by the Commission in December, 1970, effective 6 months later for the then five member countries, and was effective in Venezuela as of January 1, 1974. This Code was designed to promote indigenous capital formation, protect ANCOM from foreign domination (preserving its benefits for nationals), and prevent the internal competition of member countries in attracting foreign capital and technology. The idea was to regulate the inward flow of vital new foreign capital and technology and direct its allocation as much as possible, without impeding it or encouraging the outflow of existing capital.

Other measures designed to achieve standardization of economic policy include a simplified structure for a uniform Andean

⁶ U.S. Dept. of Commerce, CBR 73-49, The Andean Common Market: Implications for U.S. Business at 4 (1973); see also Furnish & Atkin, *supra* note 4.

⁷ Decision No. 24, Common Regime for Treatment of Foreign Capital and of Trademarks, Patents, Licenses and Royalties, 11 ILM 126 (1972). All references to the ANCOM Code or Decision 24 include the modifications contained in Decisions 37, 37a and 70.

tariff classification (NABANDINA), a double taxation agreement, coordinated export promotion measures, provisions for Andean Multinational Enterprises,⁸ harmonization of monetary policies (including exchange rates), Uniform Industrial Property Rules,⁹ a proposal to create an Andean judicial institution for dispute settlement,¹⁰ and a number of other rules or practices which would affect trade, transportation, and industrial development in the subregion.

B. VENEZUELAN ENTRY AND DECREES 62 AND 63

By adhering to the Consensus of Lima, Venezuela cast its lot with its Andean neighbors and accepted full membership in ANCOM. Although it had participated in all discussions in regard to formation of the market, it had not joined ANCOM allegedly due to the unacceptable trade terms contained in various provisions in the Cartagena Agreement or possibly due to unresolved differences between the Venezuelan public and private sectors in the early stages of the previous administration. Notwithstanding, Venezuela had participated fully in the Andean Development Corporation (CAF), which was chartered prior to the signing of the Cartagena Agreement. CAF was designed to be the key development financing institution to mobilize additional resources and promote investment. Draft legislation circulating in the Venezuelan Congress during the previous administration¹¹ contained much language and philosophy from Decision 24, and it was generally understood long before formal ratification and entry into ANCOM that Venezuela was moving in the same direction.

With the inauguration of the new administration in early 1974,¹² little time was wasted in issuing the regulations referred to in Chapter III of Decision 24. On April 28, 1974, Decree 62 was issued, effectively defining the sectors of economic activity in Venezuela which were to be reserved to national companies,

⁸ Decision No. 46, Andean Code on Multinational Enterprises and the Regulations with Regard to Subregional Capital (Dec. 18, 1971), 11 ILM 357 (1972).

⁹ Decision No. 85, Decision on Industrial Property, 13 ILM 1489 (1974).

¹⁰ Previous dispute settlement procedure referred to the Montevideo Treaty which created LAFTA, which contained a rather loosely structured arrangement.

¹¹ Social Christian Administration of President Rafael Caldera.

¹² Democratic Action Party and President Carlos Andres Perez.

and barring new foreign investment therein.¹³ On the same day, Decree 63 was issued,¹⁴ creating the Superintendency of Foreign Investments (SIEX) within the Ministry of Development as the competent national organization to implement the purposes set forth in Decision 24. SIEX has control over the treatment of foreign capital and contracts involving any form of technology transfer (for example, exploitation of trademarks or patents, licenses, payment of royalties for technical assistance, know-how, management assistance or certain types of training). Among other responsibilities, SIEX is charged with the approval of requests for foreign investment,¹⁵ contracts regarding the transformation of foreign¹⁶ companies into national¹⁷ or mixed¹⁸ companies, and authorization of contracts regarding importation of technology. The statute provides the agency with the appropriate resources to enforce its responsibilities,¹⁹ including the usual mechanisms to coordinate with the Central Bank and other high level government functions to control local credit availability and profit remittances.²⁰

C. SIGNIFICANCE OF NATIONALIZATION OF PETROLEUM AND IRON ORE

This article will attempt to place in perspective these two recent and extremely significant legal developments. Local control of resources and technology may be viewed as a means to further the anticipated industrial development. Subregional economic integration may be viewed simply as a means to realize greater return on the investment produced by such industrial development. In this context, Venezuelan nationaliza-

¹³ Decree 62, Art. 1 (published in Official Gazette of Apr. 29, 1974, Extraordinary Issue No. 1,650); 13 ILM 1220 (1974).

¹⁴ Decree 63 (published in Official Gazettes No. 1,650 and No. 30,412 of May 31, 1974); 13 ILM 1221 (1974).

¹⁵ *Id.* at 1223-1224.

¹⁶ Those Companies with national capital of less than 51 percent or a higher amount if that percentage is not reflected in the technical, financial, administrative and commercial management of the company. See Decision 24, art. 1, ch. 1, at 128.

¹⁷ Those companies with national capital of 80 percent or more.

¹⁸ Those companies with national capital between 51 percent and 80 percent, provided that proportion is reflected in the disciplines listed in note 16 *supra*.

¹⁹ Decree 63, art. 10 through 18, at 1223.

²⁰ *Id.* art. 11, at 1223.

tion of its iron ore concessions²¹ and petroleum industry²² in 1974 and 1975 may be more readily appreciated.

Over the last decades, U.S. investors in Latin America have become sensitive to the widely discussed legal issues of valuation and compensation in circumstances involving settlement of claims for expropriated or nationalized property.²³ There is an increasingly direct relationship between the method of valuation²⁴ of direct foreign investment to be registered under Decree 63 and the standard to be applied to determine the valuation and compensation in the event that this same investment was to be nationalized at a later date. Indeed, the provisions of the petroleum nationalization law begin with a concept which sounds like book value and contain adjustments deemed to be appropriate,²⁵ while Decree 63 refers to "existing net worth at book value" determined in accordance with generally accepted accounting principles.²⁶ The writer has thus far failed to notice any successful attempt to involve excess profits adjustments such as those applied in the copper cases in Chile.²⁷

Although no conclusion can be drawn from the above, it is believed that considerable discussion and negotiation preceded the establishment of the norms used by the Venezuelans in their offers and resolution of compensation with steel and oil company representatives. In his address presented upon the signing of the petroleum nationalization law, President Andres Perez observed that:

Iron ore and oil are now definitely in our own hands, and we are therefore bound to assume the most exacting responsibilities on the road towards Latin America's economic liberation. Our actions belong to the democratic system established by our

²¹ Decree of President Carlos Perez announcing nationalization of Venezuelan iron ore concessions. Published in *Venezuela Today*, Oficina Central de informacion Caracas, Venezuela, Sept. 1975, No. 3, at 3.

²² Organic Law Reserving to the State the Industry and Commerce of Hydrocarbons, Aug. 29, 1975, 14 ILM 1492 (1975). [hereinafter cited as Organic Law]

²³ See Roundtable discussion in Proceedings, 66 AM. J. OF INT'L L. 205-226 (1972) for an interesting exchange of views.

²⁴ Decree 63, art. 19, at 1224.

²⁵ Organic Law, articles 12, 15, 16 and 17, especially art. 15.

²⁶ Decree 63, art. 19, at 1224.

²⁷ See Decree concerning excess profits of copper companies, Sept. 28, 1971, 12 ILM 983 (1973) However, reports of recent proposals from the Venezuelan government regarding the proposed extraordinary nationalization of Owens-Illinois investments have contained references to these concepts. See N.Y. Times, Apr. 7, 1976, at 68, col. 4.

people through the Constitution of 1961. History will tell about the prowess of a developing nation ruled by a democratic and constitutional system which took the basic industries into its own hands without any retaliative fits to vindicate the rights of Venezuela with thoughtful and creative intelligence.

We have not copied anybody's methods or procedures to carry out our democratic and nationalistic revolution. We developed our own legal mechanisms without making any concessions nor spoiling our dignity as a free country, and without impairing the sovereign rights of the nation.²⁸

Aside from the political nature and timing of those remarks, the attitudes represented above may be instructive to the foreign attorney who must advise his client on the approach to be taken in negotiating specific language in agreements involving the transfer of technology which is both necessary and desirable for the host country to further its industrial development goals. As will be discussed, the technocrats within SIEX who are charged with the responsibility of conforming technology agreements to national goals as depicted in the relevant provisions of Decree 63, may exercise considerable discretion in making their decisions. The same may be said for the procedures established to convert foreign companies to national companies in reserved sectors and to approve new investment in others. This overall pattern should be noted before the practitioner prepares his own analysis in respect of his particular situation and objectives.²⁹

D. FOREIGN INVESTMENT

Reserved Industries

According to Decree 62, certain sectors of economic activity are thereafter reserved to "National Companies" (companies whose capital belongs at least 80 percent to national investors³⁰) and no new direct foreign investment is permitted. Those reserved sectors include public services (including the generation, transmission, sale and distribution of electricity; communications; water and sewage; postal; and law enforcement or any protection or security services for persons or property³¹), TV and radio broadcasting, Spanish language newspapers and magazines, advertising and publicity, internal trade (commercialization) or

²⁸ Nationalization of the Oil Industry at 15, Oficina Central de información, Caracas, Venezuela (Aug. 19, 1975).

²⁹ Decree 63, Arts. 54-63; especially art. 57, at 1230-32.

³⁰ See notes 16-18 *supra*.

³¹ Decree 62, art. 1A, at 1220.

marketing of goods and services by businesses dedicated to these activities (that is, retailing and some wholesaling trade), and internal transportation of persons and property.³²

Also reserved to national companies are professional services and activities of consulting, advice, design and analysis of projects and the realization of general studies in an area which requires the participation of professionals, such as, engineers, whose practice is regulated by national laws.³³ This reservation would seem to exclude such activities as process engineering (including design of processing plants in primary and secondary industrial development sectors) where the high technology involved clearly does not yet exist in national companies in Venezuela. However, the Superintendent of SIEX has advised³⁴ that joint ventures between national companies and foreign companies (less than 51 percent nationally owned³⁵) would be approved in these cases. Thus, the Venezuelan government is simultaneously calling for foreign investment in those industries open to it under the Sectoral Program (that is, petrochemical) and placing serious restrictions on those companies with the technology to assist in the design and construction of plants for the same industries.

For example, if Venezuela wants to process more hydrocarbon by-products and participate at different levels in petroleum, it will build an ethylene plant to use as a building block for a plastics industry instead of exporting crude oil. Since no Venezuelan engineering company presently has the "front end" design and engineering capability to build an ethylene plant, PETROVEN³⁶ would presumably call for competitive bids from foreign companies for the project. It is not clear at this writing whether a U.S. engineering company could undertake this project without a Venezuelan partner. It would appear from Decree 62, however, that such a company could not establish a Venezuelan subsidiary to perform studies to determine the feasibility of establishing such a plant or plants to process crude

³² *Id.* art. 1B, at 1220.

³³ *Id.* art. 1C at 1220.

³⁴ Interview with Dr. Rafael Soto Alvarez, Venezuelan Superintendent of Foreign Investment and Technology Transfer, in conjunction with ANCOM workshop on Technology Transfer held in Pittsburgh, Pa., Feb. 10, 1976 sponsored by the Council of the Americas.

³⁵ See notes 16-18 *supra*.

³⁶ Venezuelan (National) Petroleum Corporation established pursuant to Decree 260 of Apr. 19, 1960, and designated by the nationalization law to be the holding company for all petroleum operations. See, Organic Law, art. 6 at 1493-94.

oil by-products unless the foreign investor was prepared to own only 20 percent or less of this Venezuelan company. Feasibility studies of this nature are invariably required by lending institutions prior to making final commitments to finance projects such as plant construction. With the indication from SIEX that some sort of joint venture will be encouraged and approved for these projects, U.S. engineering companies are advised to make plans and preparations well in advance to evaluate joint venture prospects and determine the commercial conditions they would be willing to accept in such venture, before investing a substantial amount in proposals for the projects themselves.

Foreign companies which operated prior to May 1, 1974, in the reserved sectors are given a period of 3 years from that date to divest themselves of at least 80 percent of their shares to national investors, thereby becoming national companies.³⁷ Insurance, banking and other financial institutions, petroleum and mining remain governed by special laws in force in the country,³⁸ but SIEX is authorized to monitor the technical, commercial and management participation by national investors in such enterprises to assure that these activities are consistent with their participation in the capital. Finally, Decree 62 provides a procedure for future reservation of other industries for development by national companies.³⁹

E. PARTICIPATION IN ANCOM BENEFITS: LIMITATION AND FADE-OUT

Since the program of subregional development and market expansion was designed to generate new investment requirements in different sectors, the foreign investment code was established to directly benefit national or mixed⁴⁰ enterprises and only indirectly benefit foreign enterprises.⁴¹ Foreign investment is encouraged for its contribution to the national goals of development and integration and thus is given guarantees as well as non-discriminatory treatment for its protection.⁴² Consequently, the advantages derived from the ANCOM duty-free program will accrue only to products produced by national or mixed companies and foreign companies which are in the process

³⁷ Decree 62, art. 2, at 1220.

³⁸ *Id.* art. 4, at 1221.

³⁹ *Id.* art. 5, at 1221.

⁴⁰ Decision 24, Decl. 1, at 127.

⁴¹ *Id.* Decl. 2, at 127.

⁴² *Id.* Decls. 3-4, at 127.

of being transformed into national or mixed companies.⁴³ Foreign companies which do not agree to be transformed will be denied certificates of origin for their products and the concomitant duty advantages.⁴⁴

Transformation (frequently called divestment or fade-out) rules require foreign companies to sell to national investors at least 15 percent of the capital within 3 years, 30 percent within 5 years, 45 percent within 10 years, and 51 percent within 15 years.⁴⁵

F. REGISTRATION, PROFIT REMITTANCES, REINVESTMENT AND REPATRIATION

To obtain the right to remit profits abroad and to repatriate invested capital, all owners of a direct foreign investment (DFI) must register with SIEX an agreement setting forth the conditions of the authorization and the amount of the investment in freely convertible currency (dollars).⁴⁶ In the case of companies existing as of January 1, 1974, the DFI shall consist of their existing net worth at book value, determined in accordance with generally accepted accounting procedures.⁴⁷ Note, however, that the statute provides that SIEX has the power to accept or reject the inclusion of certain questionable assets in the DFI. In the case of DFI subsequent to that date, the amount will be the amount of bolivars (at official exchange rate) of the foreign currency officially brought into the country (recorded by Central Bank transfers) or by the actual invoice cost in bolivars in the case of machinery, merchandise, industrial plants or equipment.⁴⁸ Technology is not computed as capital contributions by the owner or supplier of technology to a national or mixed recipient company⁴⁹ and, therefore, is presumably not DFI.

Foreign investors will have the right, after appropriate SIEX authorization, to remit abroad in freely convertible currency, profits not exceeding 14 percent of the registered DFI (the base) calculated after deducting taxes (net).⁵⁰ This limitation does not apply to the national investors in the same companies.

⁴³ Decree 63, art. 51, at 1229; and Decision 24, art. 27, at 135.

⁴⁴ Decree 63, art. 52, at 1229; and Decision 24, art. 29, at 136.

⁴⁵ Decision 24, arts. 28, 30, at 135-136.

⁴⁶ Decree 63, art. 30, at 1226; and Decision 24, art. 5, at 130.

⁴⁷ Decree 63, art. 19, at 1224.

⁴⁸ Decree 63, art. 22 at 1222 and art. 32 at 1226.

⁴⁹ Decree 63, art. 59, at 1231.

⁵⁰ Decree 63, art. 64, at 1234; and Decision 24, art. 37, at 138.

Reinvestment of net profits up to 5 percent of DFI base annually will be permitted without additional authorization.⁵¹ This reinvestment must be registered with SIEX and becomes an addition to the DFI base for purposes of remittances and repatriation of capital. Venezuelan regulations contain a provision enabling investors to average this authorized annual 5 percent for up to 3 to 5 years. National and mixed companies, as well as foreign companies which have agreed to transform, are not subject to these limits, but must still register the reinvestment, which must remain proportionate to the shareholder's interest (that is, not retransform the mixed or national company into a foreign company or change the ownership percentage).⁵² Upon liquidation of the company or the sale of its shares to national investors, the foreign investor is entitled to repatriate the resulting proceeds.⁵³ In case of a reduction of capital of a foreign company, the investor will be entitled to remit abroad only that part corresponding to DFI providing SIEX has approved the reduction.⁵⁴

G. RESTRICTIONS ON BORROWING

A distinction is made between local credit and foreign credit, and both are subject to some restrictions. Access to internal or local credit by foreign companies is limited to short term borrowing only and in accordance with conditions established by SIEX.⁵⁵ All foreign borrowings, including those by national or mixed companies, must be authorized by and registered with SIEX, which is empowered to establish overall debt limits.⁵⁶ These foreign borrowings will serve as a basis for later remittance authorizations.⁵⁷

SIEX, in conjunction with the Central Bank, will also establish a maximum effective rate of interest on foreign credit agreements, which must bear some close relation with the prevailing interest rates in the home country of the foreign investor. In foreign credit agreements between a company and its foreign parent or affiliate, the effective rate is not to exceed 3 percent

⁵¹ Decree 63, art. 38, at 1227.

⁵² Decree 63, art. 39, at 1227.

⁵³ Decree 63, art. 33, at 1226.

⁵⁴ Decree 63, art. 34, at 1227.

⁵⁵ Decree 63, art. 45, at 1228.

⁵⁶ Decree 63, arts. 40-41, at 1227-1228.

⁵⁷ Decision 24, art. 16, at 132.

over the rate for first class securities in the home market⁵⁸ (apparently equivalent to 3 percent over U.S. prime lending rate). Attempts are being made to improve the existing financial structure in the country in order to encourage capital formation for the development process.⁵⁹

H. CRITERIA FOR NEW DFI

In the context of this background, one can readily understand the importance of adequate investigation prior to preparation and submittal of an application for approval of new DFI. The statute gives broad general authority to the National Executive⁶⁰ and then lists the criteria for approval of new DFI when companies agree to:

- 1) Incorporate in its products a national value added of 50 percent or greater;
- 2) Promote exports with value added of at least 30 percent;
- 3) Generate a significant volume of employment;
- 4) Locate in relatively less developed areas of the country;
- 5) Incorporate technology advantageous to the country;
- 6) Transform to mixed or national companies at accelerated rates; or
- 7) Invest or reinvest in Portfolio Development Securities.⁶¹

It is emphasized once again that SIEX possesses a certain amount of discretion and has indicated it will maintain flexibility on a case-by-case basis.⁶²

I. RECENT DEVELOPMENTS

It is understood by this writer that several discussions have been held by the Commission of ANCOM and its Consultative Committee (high level experts from the competent national authorities of the member countries) in relation to modifying Decision 24, which changes would then be implemented by each member country. The proposed changes would expand the present definition of DFI to include used as well as new equip-

⁵⁸ Decree 63, art. 43, at 1228.

⁵⁹ See generally Wiles, *The Venezuelan Capital Markets Law*, 8 INT'L LAW 303 (1974).

⁶⁰ Decision 24, ch. I and Decree 63, chs. II & III.

⁶¹ Decree 63, art. 27 at 1225.

⁶² Note 34, *supra*.

ment, machinery, raw materials, intermediate and final products, and replacement parts. Also included would be all monies in local currency, specifically including amortization and interest payments, proceeds from sale of shares plus any capital gains, and royalty or other payments for technology.

The proposed changes would treat local branches of foreign companies like subsidiaries. Whether or not these local branches would be subject to fade-out rules has not been resolved.

With respect to the 14 percent profit remittance ceiling, apparently no agreement was reached but there was an inclination to increase the level. The question of what happens to earnings in excess of 19 percent (the 14 percent ceiling plus the 5 percent reinvestment allowance) was not answered. Currently it is assumed that this excess is to be invested in the Portfolio Development Securities or retained as surplus (the usual case), but it has been suggested that the foreign investor who did not receive approval for higher ceilings would be required to distribute it in some unexplained manner or reinvest without benefit of addition to the registered base.

Two other points discussed are worthy of mention. Foreign companies would still be limited to short term local credit, but the amount allowed would be 150 percent of repatriable capital, with some flexibility available for certain industries. Regarding the character of ownership, the suggestion was accepted that mixed enterprises which invest in other mixed enterprises should be considered as national investors, so long as national investors continued to predominate. More flexibility would be allowed when a foreign investor increases its percentage in a mixed company provided this did not change the character of the enterprise according to the definition.⁶³ These could have some bearing on various approaches to the Andean Multinational Enterprises permitted under the ANCOM rules.⁶⁴

J. RESULTS

Disappointment with the results of development since the issuing of Decree 63 has been expressed by both the private and public sectors in Venezuela. At a recent conference in Caracas, it was mentioned that there has been only \$25 million of direct foreign in-

⁶³ See Paper entitled "Recent Events Regarding The Possible Modification of Decision 24", at 29, presented by Dr. John R. Pate, Jr. at ANCOM workshop on Feb. 10, 1976. This paper contains an excellent summary of such developments from a political and legal viewpoint.

⁶⁴ See generally Decision 46.

vestment in the 25 months of SIEX operation since the implementation of Decree 63, including the conclusion of 14 licensing agreements.⁶⁵

K. TECHNOLOGY TRANSFER

On several occasions the Superintendent, reflecting the attitudes now prevalent in Venezuela and throughout Latin America, has stated that industrialization and development of the desired magnitude is not possible with the alleged restrictive terms of technology contracts formerly prevailing. It was thus determined to introduce some degree of order into the procedure for acquiring and developing technology.

L. REGISTRATION REQUIREMENTS

Every contract entered into by foreign, mixed and national companies regarding the importation of technology and the use and exploitation of patents and trademarks must be approved and registered with SIEX.⁶⁶ Covered contracts include those providing:

- 1) Grant for use (exploitation) of trademarks;
- 2) Grant for use or authorization for exploitation of inventions, improvements, models, and industrial designs;
- 3) Furnishing of technical know-how by means of plans, diagrams, instructive models, instructions, formulas, specifications, training of personnel and by other means;
- 4) Furnishing basic or detailed engineering for the execution of installations for the manufacture of products;
- 5) Technical assistance, in any form in which it may be furnished; or
- 6) Administrative and management services.⁶⁷

Among the terms which technology contracts must contain before approval is this interesting new feature: Contractual value of each of the elements involved in the transfer of technology, expressed in a form similar to that provided for DFI registration under Decree 63 and Decision 24.⁶⁸

⁶⁵ Statement by Dr. John R. Pate, Jr., confirmed by Dr. Rafael Soto Alvarez at the Technology Transfer seminar sponsored by the Venezuelan-American Chamber of Commerce, Caracas, Venezuela on May 11, 1976.

⁶⁶ Decree 65, art. 54 at 1230.

⁶⁷ Decree 63, art. 55 at 1230.

⁶⁸ Decree 63 art. 56(d) at 1230 and Decision 24, art. 18 at 132-133.

M. PROHIBITED PROVISIONS

SIEX will not authorize the registration or signing of technology contracts which contain clauses that:

- 1) Require the acquiring party to purchase certain raw materials, equipment, materials, or personnel from a source designated by the technology supplier;
- 2) Provide that the supplier has the right to establish prices for the resale of the products manufactured from the technology;
- 3) Restrict the volume of production;
- 4) Prohibit the use of competitive technology;
- 5) Establish the supplier's right to purchase some or all of the output;
- 6) Compel the purchaser to transfer to the supplier the rights to improvements or inventions arising from use of the technology;
- 7) Require the user to pay royalties on patents which are not used; and
- 8) Other clauses with equivalent effects.⁶⁹

In addition to those proscribed clauses which were set forth in the original Decision 24, Venezuela had added by virtue of a subsequent law passed in 1975, 10 additional prohibitions for clauses which:

- 9) Prohibit the manufacture or sale of products using the technology after the contract period ends;
- 10) Prohibit the use of technical knowledge acquired through the technology after the contract period;
- 11) Prohibit the use of similar or like commercial trademarks after the contract period;
- 12) Impose the use of a predetermined quality control system on the user;
- 13) Require the user to sell part or all of the production to the supplier;
- 14) Establish royalty payments for technical assistance not transferred;
- 15) Require royalty payments when the user has purchased the technology outright;
- 16) Require the user to pay taxes which are the responsibility of the supplier;
- 17) Oblige the user to grant an irrevocable right to sell the manufactured products to the supplier; and
- 18) Require the user to grant the supplier rights to use any inventions or improvements arising out of the processes or products which are the object of the contract.⁷⁰

⁶⁹ Decree 63, art. 57 at 1231 and Decision 24, art. 20 at 133.

⁷⁰ Decree 746, art. I, issued Feb. 15, 1975, rev. March 1, 1975.

In all cases SIEX may, upon receiving prior approval from the Council of Ministers, prohibit other clauses (as restrictive) which it determines to have a similar effect.⁷¹ Conversely, and it is emphasized again, both by statute⁷² and as a matter of application, SIEX will evaluate the effects of any of these clauses on a case-by-case basis and permit exceptions if in its discretion they are justified.

N. UNDERLYING POLICY AND ITS MANIFESTATION

High officials in Venezuela, as well as throughout ANCOM, have often expressed their objective of lessening the dependence on foreign sources by acquiring industrial technology for development within Venezuela, along with the reduction of "excessive" payments for the acquired technology (termed "monopoly rents" by some spokesmen for less developed countries).⁷³ Paying as little as possible for technology would appear inconsistent with an implied goal of obtaining the best foreign technology available. In fact, one can easily conclude that SIEX does not yet have a sufficient technically sophisticated staff responsible for evaluation of technology to appreciate qualitative differences offered by apparently competitive foreign technology suppliers. Coupled with a stated objective to diversify technology ties away from the United States (aggravated by the U.S. Trade Reform Act's exclusion of Venezuela, Ecuador, and the other OPEC members from the system of generalized trade preferences for developing countries) and toward Japan and Western Europe, and to a lesser extent, the Eastern Bloc, this reality frequently confronts the U.S. businessman trying to negotiate a technology transfer agreement in Venezuela.

To this writer's knowledge, no clear guideline or rule of thumb has yet emerged in Venezuela with respect to allowable royalty percentages, as contrasted with Brazilian practice and the Mexican technology registry. It is understood, however, that considerable time and effort is being expended by SIEX technocrats in attempting to negotiate lower royalties for technology before approving these contracts. Representatives of numerous U.S. companies have stated⁷⁴ that they also believe that the Venezuelan

⁷¹ Decree 746, art. 2.

⁷² Decree 746, art. 1, special provision entitled "Unique Paragraph" and art. 8.

⁷³ See note 34, *supra*, ANCOM Workshop, Feb. 10, 1976.

⁷⁴ See notes 34 and 63 *supra*. A transcript of this work will be published by the Council of the Americas.

party to the agreement occasionally had second thoughts and attempted to effect reductions through SIEX after the two-party arm's length bargaining had been concluded. One speaker at the recent Council of the Americas ANCOM Technology workshop stated his belief that these late negotiations frequently stretch the plant production schedule of the licensee and that any savings on royalties are more than offset by a short period of losses of production resulting from the delayed schedule.⁷⁵

Another manifestation of this policy appears in the limited term allowed for technology agreements.⁷⁶ The validity of such agreements entered into after January 1, 1974, is limited to 5 years, and SIEX has stated, subsequent to the enactment of Decree 746 requiring existing agreements (in effect as of December 31, 1973) to conform to its new rules, that these latter agreements are subject to the same maximum duration, presumably computed from date of registration.⁷⁷ Agreements which do not conform to these rules may not be legally enforceable for any purpose. This limited validity period in Venezuela is drastically shorter than the 10 year period generally allowed in other ANCOM countries and Mexico. Brazil has allowed 5 year renewals on licenses originally approved by INPI⁷⁸ for 5 years, and the 5 year period in Argentina is reportedly under pressure to be relaxed.

A comment should be made about ANCOM Decision 84⁷⁹ which has not yet been implemented in Venezuela, but from which spring several concepts which were enacted in other laws. This Decision contained provisions consistent with encouragement of "true" or "real" transfer of foreign technology and know-how, in order to stimulate local technologically related activities. Article 1c of Decree 62 reserved the sector concerning services for engineering studies, design, consulting and analysis to encourage the development of this strategic activity. Decision 84 would require SIEX to consider in its evaluation of a proposed technology contract, among other factors, the predicted effect on:

- 1) Technological development including demand for scientific and technological services in the country, use of local engineers and consultants and possible technological derivatives;
- 2) Employment;

⁷⁵ Evans, "Management Perspective of Technology Transfer to ANCOM". Paper delivered at ANCOM workshop, Feb. 10, 1976 note 34, *supra*.

⁷⁶ Decree 63, art. 56(c) at 1230.

⁷⁷ *Supra* note 63, at 14.

⁷⁸ See Pinheiro Neto, *Multinationals in Brazil*, 8 CASE W. RES. J. INT'L. L. 289.

- 3) Specific national or ANCOM development plans;
- 4) Balance of payments and generation of income; and
- 5) Environment.⁸⁰

This Decision also requires the applicant who wishes to receive SIEX approval for technology contracts to unbundle the technology package in order to assign a relative value to each element and indicate its possible local availability. SIEX has included this requirement in its application form⁸¹ which became available shortly after issuance of Decree 746. The 60 day period within which SIEX must rule⁸² on the application does not begin to run until all of the numerous documents called for by the new law have been submitted.⁸³

Finally, there appears to be a realistic determination by the Venezuelan government regarding the matter of training of nationals. Decree 63 mandates that all technology contracts must contain an obligation by the supplier to train the required national personnel in order to get better utilization from the acquired technology, and generally to promote technologically related activity (including R & D) in the country.⁸⁴ Venezuelan officials have also mentioned a proposed new decree which would refer to training programs and include a set of model clauses which would be included in technology agreements in order to achieve "true technology transfer."⁸⁵ It will be recalled that the President also emphasized training in his public statements referring to nationalization of the iron mines and petroleum industry. All of this can be seen as a realistic attempt to supply missing elements in the national structure being built in order to reduce the dependence on foreign technology.

O. OBSERVATIONS ON SIEX ATTITUDES

The Superintendent has publicly declared on numerous occasions the rationale for the seemingly rigid rules governing technology transfer. Venezuela believes that in order to foster nation-

⁷⁹ Decision 84, Decision on the Basis for a Subregional Technological Policy, 13 ILM 1478 (1974).

⁸⁰ *Id.* art. 7 at 1484.

⁸¹ SIEX Form 10, issued shortly after publication of Decree 746 on Feb. 15, 1975.

⁸² Decree 746, art. 7.

⁸³ Memorandum to clients, prepared by Dr. Thomas L. Hughes of the Venezuelan law firm of Travieso, Evans, Ponte, Rosales & Hughes.

⁸⁴ Decree 63, art. 58 at 1231.

⁸⁵ Note 34 *supra*.

ally owned industrial development, sufficient markets must be available for the products, consistent with the Sectoral Development Program and subregional integration. Thus, licensing agreements must not contain clauses prohibiting exports, since they would limit expansion potential.⁸⁶ Dr. Soto Alvarez stated, however, that their system has the flexibility to respect both the U.S. laws prohibiting re-export to certain restricted countries, and the U.S. licensor's existing commitments. When pressed on the latter problem, he advised that he could grant a waiver for prohibition of exports to Brazil, for example, based on existing market commitments of the U.S. licensor, but not to the entire Andean group.⁸⁷

A major subject of apparent disagreement between technology owners and acquirers (and consequently between industrialized nations and Third World nations) is the length of protection of industrial property including know-how. No ANCOM member has signed the International Patent Convention, and their attitudes are sharply divergent from the traditional U.S. approach. They believe that the technology will generally become stale within 5 years, and the local user should then be free to use the technology on a royalty-free basis. They believe that they are giving adequate protection to the rights of the foreign licensor, but there is a credibility gap in the evaluations of the value of those property rights, which reportedly has been apparent at recent international meetings concerning proposed codes of conduct for technology transfer.

P. UNRESOLVED PROBLEMS FOR THE FOREIGN LICENSOR

Four major problems appear unresolved at this stage, two of which may be resolved by administrative discretion. The licensor is concerned with existing commitments within the framework of a global system of licensing agreements, which grant exclusive territories in many cases. To forego the export prohibition in a Venezuelan license would not generally be economically justified in the licensor's overall program, particularly in view of the universally accepted most-favored licensee clauses. This conflict could be resolved in direct negotiations with SIEX, and will probably depend on the ability of the licensor to establish his case

⁸⁶ Remarks by Dr. Rafael Soto Alvarez at ANCOM workshop on Feb. 10, 1976.

⁸⁷ Interview with Dr. Rafael Soto Alvarez, note 34 *supra*.

with authority before the agency. Uniqueness of the technology will also be a factor.⁸⁸

The question of protection of property rights has already been discussed above and may or may not be solvable. The grant-back restriction, however, has other implications which deserve comment. The Superintendent has indicated that there will be some flexibility on a case-by-case basis, suggesting that technology may be a function of attitudes and relative benefits. It would appear that the concept of a "pool," whereby improvements made by any licensee are made available to the licensor and all licensees, would benefit a licensee in an ANCOM country (particularly in a process license) more than a licensee in Western Europe. There is more technology available to the latter (for example, Germany) and thus a greater likelihood of improvements being developed in that country.⁸⁹

More along policy lines are the last two problems facing the U.S. technology supplier. First, the idea of conclusion of arm's length negotiations which are then reopened by the government is anathema to us. Besides being frustrating, it also provides a convenient opportunity for a second chance, as previously discussed. This may be counterproductive for the host country, particularly, if the supplier of valuable technology becomes suspicious or is given an impression of less than good faith bargaining. Clearly this is not the intent of the Venezuelans, and the supplier is urged to arrange direct contact with SIEEX at the earliest possible stage, and request their formal or informal participation to reduce the complications.⁹⁰

Second, the supplier must always consider the return on his investment, in view of all of the stringent criteria presented. Higher royalties should be justified if the technology is unique. Longer term royalties and secrecy agreements are common in high technology situations between two parties in a highly industrialized society. The overall decision on allocation of resources of the supplier should consider all of these factors in a long term context.

⁸⁸ See generally, Mirabito, *The Control of Technology Transfer: The Burke-Hartke Legislation and ANCOM: The MNE Faces the Nations*, 9 INT'L LAW. 215, 222-23 (1975).

⁸⁹ Socialistic Law concepts, which are not based on the same principles of private property rights as Western law, have apparently influenced Latin American technocrats and those throughout the Third World.

⁹⁰ Note 74 *supra*.

Q. SOME LOCAL TAXATION CONCEPTS

Taxable Income and Territoriality Principle

Income is taxed when it arises from Venezuelan sources (that is, economic activities carried out in Venezuela or assets located in the country).⁹¹ The concept is broadly interpreted with respect to income, but narrowly interpreted as to expenses. Thus, income might be taxed even when incidental activity takes place in the country such as formal transfer of title or acceptance of an order for goods shipped from the United States. Expenses must be incurred clearly within Venezuela to be deductible. Costs of tangible goods shipped to Venezuela are considered to be costs incurred within the country.⁹²

The territoriality of incomes and expenses does not depend on the place of payment, but on the place where the property is located, where the transaction occurs, or where the services are performed. Expenses incurred abroad cannot be made deductible by merely having the recipients declare the amounts as income and pay Venezuelan income tax, although a leading international accounting firm claims that declaration by the recipient could be an important argument in favor of deduction in close cases.⁹³

Corporate income is taxed according to graduated rates up to 50 percent, and there is a 15 percent dividend tax withheld at the source. Branch profits are subject to the same 15 percent withholding. There is a 3 year loss carryforward provision and no carryback. A tax credit in the amount of 15 percent of the investment in fixed assets destined for production of income is available for the year of the start-up. There is also a prohibition against a company or person assuming the income tax liability of another to whom the income is owed. Although two parties may enter into a contract so providing, the agreement is neither valid nor enforceable, and both parties may be fined an amount equivalent to twice the tax.⁹⁴

Royalty income is taxable as paid or received (cash basis) and

⁹¹ VENEZUELAN INCOME TAX LAW, art. I.

⁹² Price Waterhouse & Co., Information Guide for Doing Business in Venezuela 20 (Feb. 1975).

⁹³ *Id.* at 21.

⁹⁴ The Price Waterhouse guide or any other reliable guide or summary on Venezuelan taxation is suggested for an overview, but consultation with local counsel is always recommended.

must be withheld at source.⁹⁵ The usual rate is 80 percent of the gross payment when paid to non-residents, with allowable deductions of up to 5 percent of gross revenue and reasonable amortization of the property right. Royalties are taxable when the rights giving rise to them are used in the country, regardless of where the licensor or owner of the rights is located. Decree 63 provides that payments of royalties to a foreign parent or affiliate shall not be authorized, nor will such payments be deductible for tax purposes.⁹⁶

There are special rules in Venezuela regarding taxation of a number of different types of industries, including petroleum, mining, shipping, banking, and others (some open and some now reserved to national companies). There are also stamp taxes, transfer taxes, registration fees, customs duties, municipal taxes, and taxes on capital stock and branch registration which are not herein treated. Finally, as in every country in Latin America, there are a number of laws and regulations concerning social security and various labor, educational, termination, and miscellaneous benefits.

⁹⁵ Lacey, *Technology and Industrial Property Licensing in Latin America: A Legislative Revolution*, 6 INT'L LAW. 388, 399-400 (1972).

⁹⁶ Decree 63, art. 59 at 1231.