

VENEZUELA: THE LAW ON SECURED TRANSACTIONS

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INTRODUCTION

This discussion of the Venezuelan norms on secured transactions has been prepared at the request of the Center for International Legal Studies as collaboration with UNCITRAL in its effort to prepare a model law for adoption by nations desiring to have a modern regime to facilitate the financing of international trade in especially capital goods. As the focus of the UNCITRAL law is on a regime of “security rights,” which is defined as “a consensual right in movable property that secures payment or other performance of one or more obligations,”¹ accordingly this discussion is limited to those Venezuelan norms that most approximate this objective.

The current Venezuelan norms on security rights, including the enforcement and effectiveness thereof, differ considerably from the provisions and goals of the several more modern international model conventions that have been developed in recent years by the European Bank for Reconstruction and Development, UNIDROIT, the

¹ United Nations Commission on International Trade Law, Working Group VI (Security Interests), First Session, New York, 20-24 May 2002, “Draft Legislative Guide on Secured Transactions, Report of the Secretary-General,” 12 February 2002, p. 6.

Organization of American States, and now by UNCITRAL.² Whereas these model conventions are characterized by their flexibility, simplicity, and ease and certainty of enforceability from the perspective of the creditor, in contrast the Venezuelan norms tend to be limited in scope, bureaucratic in application, and often slow and uncertain with respect to enforceability. Moreover, the Venezuelan norms evidence a nationalistic, quasi-protectionist intent. In essence, then, they may be termed largely obsolete and little suited for adequately protecting the rights of creditors, especially from abroad (as discussed below, the one exception is the more modern ship or naval mortgage). It is for this reason that in commercial practice creditors often insist on other forms of guarantee beyond, or in lieu of, the types of security rights offered under Venezuelan law, such as real property mortgages, personal guarantees, standby letters of credit, and others, or venturing into transactions without adequate security rights, frequently to their peril.

Venezuela's norms on security rights are contained in disparate sections of its dated commercial and civil codes, and in various special laws, only two of which deal exclusively with security rights. The principal special law on security rights is the Law on Chattel Mortgages and Nonpossessory Pledges ("Chattel Mortgage Law")³ of 1973. The other special law in this area is the Law on Sales with Reserve of Title ("Conditional

² See the EBRD's Model Law on Secured Transactions (1994), UNIDROIT's Convention on International Interests in Mobile Equipment and related Protocol on Matters Specific to Aircraft Equipment (Cape Town, 2001), and the OAS's Model Inter-American Law on Secured Transactions (Washington, 2002), among others. The UNCITRAL model law is still being developed as of this writing, although the guidelines for it are similar in most respects to the aforementioned model conventions.

³ Ley de Hipotecas Mobiliarias y Prenda Sin Desplazamiento de la Posesión, published in the Extraordinary Official Gazette No. 1.575 of April 4, 1973. (Note: all references to Venezuelan laws are to the current version thereof. Likewise, all references to governmental entities use the current names thereof.)

Sales Law”)⁴, which dates back to 1959. Aside from these two specific laws, Venezuelan legislation also contemplates the possibility of creating security rights in movable property in the form of a commercial law possessory pledge, a civil law possessory pledge, a ship mortgage, and financial leasing transactions. In addition, documentary repurchase (“repo”) transactions (through domestic banking institutions), warehouse receipts, guarantee trusts, and the right of retention in the case of services rendered may also be considered forms of securitization. Of these various schemes, those that most approximate the concepts and objectives of the new international model conventions are the Chattel Mortgage and Conditional Sales Laws, the traditional possessory pledges, the ship mortgage, and financial leases.

CHATTEL MORTGAGE LAW

Except for the more recently promulgated norms on ship mortgages, contained in the Law of Maritime Commerce of 2001,⁵ the 1973 Chattel Mortgage Law has been Venezuela’s sole attempt to harmonize its legislation in the area of security rights in the terms conceived in the modern model laws being developed in this area. Given the passage of time since Venezuela’s law was promulgated and the expansion of international trade and financial practices, the Venezuelan norms are now in need of modernization.

⁴ Ley sobre Ventas con Reserva de Dominio, published in the Official Gazette No. 25.856 of January 7, 1959.

⁵ Decreto No. 1.506 con Fuerza de Ley de Comercio Marítimo, published in the Extraordinary Official Gazette No. 5.551 of November 9, 2001.

Basic Provisions Common to Chattel Mortgages and Nonpossessory Pledges

Because of the similarity between chattel mortgages and nonpossessory pledges, as viewed by the drafters, both concepts were included in the same law. Hence, even though the Chattel Mortgage Law draws distinctions between the two, particularly with respect to types of movable properties that may be the subject of each and, to a lesser extent, with respect to the enforcement of the rights of a mortgagee or pledgee, nevertheless there are various provisions that are common to both types of security rights. These common provisions may be summarized as follows:

<u>Article</u>	<u>Provision</u>
1	Only those movable properties specified in the law may be the subject of a chattel mortgage or a nonpossessory pledge. If the property is owned by more than one owner, all owners must consent to the constitution thereof.
2	A chattel mortgage or nonpossessory pledge may not be constituted on property that is already subject to a mortgage or pledge, or that has been attached in a judicial proceeding, or that is not fully paid, except in the latter case in the event that the mortgage or pledge is to guarantee the purchase price, in whole or in part. Likewise, in no case may the vendor of goods that could be purchased in accordance with the Conditional Sales Law ⁶ require the

⁶ Confusingly, the Conditional Sales Law mainly defines in the negative the types of goods that could be purchased in accordance with its terms. Thus, Article 1 of this law states that it may be used for installment sales. However, Article 2 provides that goods intended especially for resale or that become part of a manufacturing or transformation process, and therefore lose their unique identity, may not be subject to a conditional sales agreement. And, Article 3 further prohibits the use of a conditional sales contract in the case of a good that is intended to become a permanent part of a real property (such that it could not be removed without causing harm to such real property) or if the goods are individually valued at less than Bs.250 (in early 2003 about US\$0.12) even when forming a group or whole that has a greater value. In

constitution of a mortgage or pledge to guarantee the total or partial purchase price; any contractual convention to the contrary is considered null and void as a matter of law.

- 3 If a chattel mortgage or nonpossessory pledge is constituted with respect to properties that cannot legally be so encumbered, then the mortgage or pledge instrument may not be registered (which is required in order to perfect the mortgage or pledge) or if registered erroneously, it is deemed to be legally invalid. In this case a good faith creditor is entitled to damages.
- 4 The instrument creating the chattel mortgage or nonpossessory pledge must be a public or duly notarized document and it must be registered as stipulated in this law. Any such instrument that is not so registered deprives the creditor of the rights of a mortgagee or pledgee.
- 5 The property that is the subject of the chattel mortgage or nonpossessory pledge remains in the possession of the mortgagor or the pledgor.
- 6 The mortgagor or pledgor cannot sell or encumber the property that is subject to the mortgage or pledge without the consent of the mortgagee or pledgee. If the mortgagor or pledgor does so, the guaranteed debt is deemed immediately due and payable.
- 7 The chattel mortgage and nonpossessory pledge extend to any insurance proceeds on the subject property, provided that the covered event occurs after the constitution of the mortgage or the pledge; likewise, the mortgagee or pledgee is entitled to any payment in the event of expropriation for a public

contrast, as described *infra*, the Chattel Mortgage Law is specific with respect to the types of property that may be subject to a mortgage or a pledge.

purpose. If the insurer is required to pay any indemnization prior to the due date of the guaranteed obligation, and provided that the insurer had been notified of the mortgage or the pledge prior to the constitution thereof, the insurer shall pay or deposit the insurance proceeds in accordance with that agreed by the parties; in the absence of any agreement, the insurer shall deposit the funds as contemplated in the Civil Code.⁷

- 8 The mortgagor or pledgor can make use of the subject goods exercising normal care and is obligated, at its own expense, to undertake all acts of conservation, repair and conditioning as may be necessary. If so agreed with the mortgagee or pledgee, the owner of the subject goods may industrialize or transform said goods in accordance with normal economic uses, in which case the guarantee extends to the products or results of such activities.
- 9 If the mortgagor or pledgor is obligated to insure the subject goods and then does not pay the premium due the mortgagee or pledgee may opt between declaring the debt to be immediately due and payable or paying the unpaid insurance premium. In the latter case the amount paid by the mortgagee or pledgee shall be due together with the principal of the debt, plus interest either at the rate stipulated in the debt instrument or at the current market rate, but provided that this additional indebtedness does not exceed the sum stipulated in the guarantee agreement for costs and expenses.⁸

⁷ Código Civil, published in the Extraordinary Official Gazette No. 2.990 of July 26, 1982. Articles 1306-1313 contemplate the deposit of funds owed by an obligor with a court of competent jurisdiction.

⁸ The sum stipulated in addition to the principal amount of the debt and conventional interest thereon is set as a maximum of 30% for attorneys' fees (Art. 286 of the Código de Procedimiento Civil, published in the Extraordinary Official Gazette No. 4.196 of August 2, 1990), to which is usually added a further 10%-25% for judicial and other execution expenses.

- 10 Chattel mortgages or nonpossessory pledges may be constituted over current accounts receivable, bills of exchange or other credit instruments that may be transferred by endorsement.
- 11 In the case of current accounts receivable, the guarantee instrument must stipulate the maximum amount of the guarantee and the conditions with respect to demanding payment.
- 12 In the case of bills of exchange and endorsable instruments, the guarantee agreement must also indicate the number and value, corresponding series, issue date, term and method of cancellation, and any other characteristics that establish the conditions of the instruments involved.
- 13 A chattel mortgage or nonpossessory pledge may cover rents or other periodic payments. In this case the guarantee agreement must expressly refer to the underlying contract or instrument, the term thereof, the conditions of payment thereof, and other provisions regarding the termination thereof.
- 14 A chattel mortgage or nonpossessory pledge may guarantee future or conditional obligations, in which case the mortgage or pledge will be valid vis a vis third parties from the moment of registration thereof, provided that the obligation arises or the condition is satisfied.
- 15 A chattel mortgage or nonpossessory pledge can only be transferred or assigned together with the guaranteed credit to another creditor of the mortgagor or pledgor. Any such assignment must be effected by public or notarized document and be registered by a new filing in favor of the assignee, that must be an eligible mortgagee or pledgee, as specified in Article 19 of the

Chattel Mortgage Law (see *infra*). Notwithstanding, in the case of a bill of exchange or endorsable instrument, the assignment shall be deemed effective upon the due endorsement.

- 16 Without prejudice to Article 6 of the Chattel Mortgage Law (*supra*), if the mortgagor or pledgor sells or encumbers the subject goods without the consent of the mortgagee or pledgee, the mortgagor or pledgor shall be deemed to have committed a fraudulent act in accordance with the Criminal Code.⁹ If the mortgagor or pledgor is a company, the criminal sanctions shall be applied to those who committed the act. However, any criminal actions shall only proceed on the basis of a complaint filed by the mortgagee or pledgee.
- 17 With respect to the subject goods, the chattel mortgage and nonpossessory pledge guarantee the creditor the payment of the guaranteed principal, interest due, and such execution costs and expenses as were stipulated in the guarantee instrument. Moreover, the mortgagee or pledgee shall enjoy a privilege with respect to all other creditors, except in relation to judicially ordered expenses of conservation or execution in the interest of the mass of creditors.¹⁰
- 18 The statute of limitations for the execution of a chattel mortgage or nonpossessory pledge is two years from the date when the action could have been brought.
- 19 A chattel mortgage or nonpossessory pledge is only legally available to the following creditors: (1) the nation, states and municipalities, Central Bank,

⁹ Article 464 of the Código Penal, published in the Extraordinary Official Gazette No. 5.494 of October 22, 2000.

¹⁰ Article 1870(1) of the Civil Code.

state entities and companies; (2) foreign banks and financial institutions duly authorized by the Superintendency of Banks; (3) domestic financial institutions governed by the General Law of Banks and Other Financial Institutions¹¹ and that are supervised by the Superintendency of Banks; (4) domestic insurance companies; and (5) companies or individuals duly authorized by the Ministry of Infrastructure, with respect to chattel mortgages on automotive vehicles and machinery, and on aircraft, the Ministry of Production and Commerce, with respect to chattel mortgages on mercantile establishments, industrial machinery, and intellectual property, and the Ministry of Agriculture and Land, with respect to nonpossessory pledges on the kinds of property contemplated in this law.

Comparative Comments

With reference only to the preceding articles of the Chattel Mortgage Law, there are a number of basic differences between its provisions and those of the several more modern model laws referred to above. First, as stipulated in Article 1 of the Chattel Mortgage Law, a chattel mortgage or nonpossessory pledge may only be constituted with respect to the specific categories of properties identified in the law (these are specified in Articles 21, as to chattel mortgages, and 51, as to nonpossessory pledges; see the discussion *infra*). In contrast, the Model Inter-American Law on Secured Transactions (hereinafter “Inter-American Law”) provides that a security right can be created with

¹¹ Ley General de Bancos y Otras Instituciones Financieras, published in the Extraordinary Official Gazette No. 5.555 of November 13, 2001.

respect to “any movable property;”¹² and the Model Law on Secured Transactions of the European Bank of Reconstruction and Development (hereinafter “EBRD Law”) provides that a security right may be created on “anything capable of being owned”.¹³ On the other hand, the UNIDROIT Convention on International Interests in Mobile Equipment (hereinafter “UNIDROIT Convention”) is specific with respect to only certain types of capital goods; moreover, the security rights that may be created with respect to them are, or are to be, further regulated in separate protocols.¹⁴ In order for Venezuelan law to be more attractive to, particularly, international capital goods vendors and creditors, it would be preferable to follow the flexible approaches of the Inter-American Law and the EBRD Law.

Second, in relation to Article 2 of the Chattel Mortgage Law, it may be noted that none of the newer model laws prohibit the constitution of more than one security right on the same goods or property. While the Inter-American Law is silent with respect to this, the EBRD Law and the UNIDROIT Convention so permit by implication.¹⁵ Likewise, none of these model laws require the use of a conditional sales scheme in lieu of a chattel mortgage or nonpossessory pledge. Again, the Inter-American Law is silent as to this, whereas the EBRD Law expressly includes conditional sales agreements, as well as possessory pledges,¹⁶ and the UNIDROIT Convention expressly includes conditional sales agreements and leases, whether or not with a coupled option to purchase the leased

¹² Inter-American Law, Article 3.V.

¹³ EBRD Law, Article 5.2.

¹⁴ As specified in Article 2.3 of the UNIDROIT Convention, it applies only to airframes, aircraft engines and helicopters; railway rolling stock; and space assets. The only protocol to have been yet adopted is the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment (Cape Town, 2001).

¹⁵ See Article 17.1 of the EBRD Law and Article 29.1 of the UNIDROIT Convention.

¹⁶ Article 6.1.

item.¹⁷ In these respects, the corresponding norms of Venezuelan law are unnecessarily restrictive and obsolete. There is, we suggest, no reason why more than one security interest cannot be created in the same item of property, provided that the priority rights of the different mortgagees or pledgees are adequately established (as is permitted in the case of ship mortgages; see *infra*). Also, as is observed below in the discussions on conditional sales and financial leases, the conditional sales law is in need of modernization and the concept of financial leases needs to be extended to international transactions.

With reference to the formalities of a public or notarized instrument stipulated in Article 4 of the Chattel Mortgage Law, it may be noted that none of the referred to model laws require more than a simple written document, and that the Inter-American Law and the UNIDROIT Convention have even adopted the more modern convention of permitting such documents to be in teletransmissible and electronic form.¹⁸

Lastly, in relation to Article 19 of the Chattel Mortgage Law, it may be noted that none of the cited model laws require prior governmental authorization to constitute a chattel mortgage or nonpossessory pledge, as is the case in Venezuela, except for other governmental entities, and domestic banks and insurance companies that are mortgagees or pledgees. Accordingly, in the cases of commercial creditors, whether domestic or international, this authorization obligation creates an unnecessary burden of bureaucratic review and delay. In practice, this means that the parties involved in a chattel mortgage

¹⁷ Article 2.2.

¹⁸ See Article 1(nn) of the UNIDROIT Convention and Article 7 of the Inter-American Law.

or nonpossessory pledge transaction must first prepare their documentation and then submit it for approval to the corresponding governmental agency, which approval often delays for up to two months, thereby serving as a substantial obstacle to dynamic modern business practices. In this respect, then, Venezuela would be well served by adopting the more automatic concept of these model laws.

Provisions on Chattel Mortgages

<u>Article</u>	<u>Provision</u>
20	A chattel mortgage affects, directly and indirectly, the subject goods, regardless of who is in possession of them when the underlying obligation is fulfilled.
21	Only the following types of property may be subject to a chattel mortgage: (1) mercantile establishments and unincorporated businesses; (2) automotive vehicles of all types, as well as railway rolling stock; (3) aircraft; (4) industrial machinery; and (5) copyrights and intellectual property. This provision further stipulates that the property items specified in Article 51 of the law may not be subject to a chattel mortgage (but rather to the nonpossessory pledge), and ships are subject to a special law (now the Law of Maritime Commerce; see <i>infra</i>).
22	This article stipulates the minimum information or mentions that must be included in a chattel mortgage, which in summary are the following: (1) full description of the mortgagee; (2) full description of the mortgagor; (3) financial particulars, including the amount of the mortgage expressed in

Venezuelan currency,¹⁹ interest rate or rates, term, place and form of payment, and the amount stipulated for execution costs and expenses; (4) a description of the goods subject to the mortgage, indicating the particulars thereof that facilitate their identification; (5) mention of proof of ownership of the subject goods and a declaration by the mortgagor that they are not subject to any other encumbrance; (6) mention of the obligation of the mortgagor to contract insurance coverage for the subject goods at its expense, if so agreed, or if insurance cover already exists, specification of the policy(ies); and (7) specification of the domicile of the obligor for purposes of service of process.

23 When various items of property are mortgaged to guarantee the same debt, the amount of principal, interest and costs attributable to each must be specified.

24 The mortgagor is obligated to conserve the goods subject to the mortgage to the standard of normal care, as well as to effect all repairs and other tasks necessary for their conservation or conditioning.

Special Rules on Mercantile Establishments

<u>Article</u>	<u>Provision</u>
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25	In order to mortgage a mercantile establishment the company or entity must be registered in the corresponding mercantile registry and it must own or lease the premises where the business is conducted.
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¹⁹ A chattel mortgage may be denominated, and enforced, in a foreign currency; notwithstanding in accordance with the provisions of Article 117 of the Law of the Central Bank (Ley del Banco Central, published in the Extraordinary Official Gazette No. 5.606 of October 18, 2002) all amounts expressed in a foreign currency in a public document must also indicate the equivalent in bolivars, the Venezuelan currency, at the approximate exchange rate prevailing at the time of subscription of the documents.

- 26 In addition to the items specified in Article 22, supra, the mortgage document must also indicate the right of the mortgagor to the premises; if rented, the lease terms must be specified.
- 27 A chattel mortgage on a mercantile establishment obligatorily extends to any fixed or permanent installations, provided that the mortgagor is the owner thereof. In the event that the mortgagor is a lessee, upon execution of the mortgage the purchaser is subrogated to the rights of the mortgagor and becomes liable for any debts to the lessor; if the mortgagor is the owner of the premises, the purchaser acquires the rights of a lessee. Any norms regulating property rentals must be complied with.
- 28 Unless expressly excluded, the mortgage shall include (1) all trade names and intellectual property; and (2) all machinery, equipment, furnishings, and so forth, of the establishment. All of these items must be described in the mortgage.
- 29 In addition, it must be expressly stated that the items referred to in Article 28, supra, belong to the mortgagor and that they are a permanent part of the business.
- 30 If expressly so agreed, and provided that the mortgagor is the owner thereof, a chattel mortgage on a mercantile establishment may extend to include the raw materials and other inputs used by the business. In this case the mortgagor must maintain at least the same stock of such raw materials and inputs, unless

the parties agree otherwise. Good faith purchasers of the resulting products shall acquire the rights accorded in the norms on commercial transactions.²⁰

31 Unless otherwise agreed, the mortgagee shall have the right to inspect the books and records of the mortgagor. Likewise, the mortgage may require the mortgagor to provide periodic reports on the status of the business.

32 The mortgagor is obligated to continue the business in accordance with normal commercial practices, to notify the lessor (if pertinent) of the constitution of the mortgage, and to notify the mortgagee, within six days, of any event that could negatively affect the business.

33 The mortgagee may declare the indebtedness to be immediately due and payable, and proceed to execute the mortgage in the event of (1) default by the mortgagor of any of the conditions stipulated in Articles 31 and 32, supra, and in particular with respect to any rent payments, the payment of salaries, or the payment of any insurance premium; (2) termination, for any legal reason, of the lease of the premises, except in the case that the mortgagee has consented to a change of location of the mortgagor; (3) unless expressly agreed, any change in the business of the mortgagor; (4) the sale by the mortgagor of any of the items subject to the mortgage, without the consent of the mortgagee; (5) the unreplenished reduction of 30% or more of the raw materials or other inputs of the business; and (6) any other legal or contractual stipulation of default by the mortgagor.

34 If the mortgagor terminates the lease of the premises, or abandons the premises, this will have no legal effect on the rights of the mortgagee. If for

²⁰ See Articles 789 and 794 of the Civil Code.

any reason the lease is legally terminated, this will not affect the rights of the mortgagee over all other subject items.

Special Rules on Automotive Vehicles

<u>Article</u>	<u>Provision</u>
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| 35 | All forms of automotive vehicles that are self-propelled, but including railway rolling stock and construction, industrial and transportation equipment that can be moved, may be the subject of a chattel mortgage. |
| 36 | In addition to the other obligatory mentions in the mortgage document, a mortgage on vehicles must include descriptions of the type of vehicle, brand, model, serial number, capacity and weight, horsepower, use, and any other specifications that may be useful for its identification. |
| 37 | Unless agreed to the contrary, mortgaged vehicles must be insured against theft and destruction of any nature. |
| 38 | Unless agreed to the contrary, mortgaged vehicles may not be taken out of the national territory, although they may circulate within the country. |

Special Rules on Aircraft

<u>Article</u>	<u>Provision</u>
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| 39 | In addition to the other obligatory mentions in the mortgage document, a mortgage on aircraft must include the (1) tail and registration numbers granted by the air registry of the Ministry of Infrastructure; (2) make, serial number, manufacturer and its nationality, date of manufacture, and any other |
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characteristics to facilitate identification; and (3) exact indication of all current insurance policies.

40 Unless expressly agreed to the contrary, the mortgage shall extend to the engines, navigation equipment, tools, fittings, and all other accessories that are generally considered to be part of the aircraft, even though these are separable from it. Unless agreed otherwise, the mortgage shall cover these accessory items even if they are separated from the aircraft, as well as any replacements thereof. Likewise, any stored replacement parts may also form part of the mortgage, provided they are inventoried and expressly included in the mortgage.

41 Without prejudice to that provided in the second paragraph of Article 17 of the Chattel Mortgage Law, the following debts will be privileged over the rights of the mortgagee: (1) liabilities for damages caused by the aircraft,²¹ and (2) rescue expenses if the aircraft were in danger and the expenses for its last flight.²²

Special Rules on Industrial Machinery

<u>Article</u>	<u>Provision</u>
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42	All machinery and equipment that is installed or intended for use in an industrial activity may be mortgaged. Unless provided otherwise, a mortgage on a building does not include any industrial machinery installed therein,
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²¹ Article 74(3) of the Law of Civil Aviation (Decreto con Fuerza de Ley de Aviación Civil), published in the Official Gazette No. 37.293 on September 28, 2001. See Articles 142-157 regarding such liabilities.

²² *Id.* Article 74(4).

unless it could not be removed without causing substantial harm to the building.

43 In addition to the other obligatory mentions in the mortgage document, a mortgage on industrial machinery must include (1) a specification of the machinery, indicating the brand, model, serial number, and other particulars to facilitate identification; (2) the use given to the machinery, indicating whether the subject machinery is new, used or reconstructed, and the condition thereof; (3) the location of the building where the subject machinery is installed; and (4) location of each item of the subject machinery within the building.

44 The mortgagor can make normal use of the mortgaged machinery, provided its value is not reduced. The mortgagor is responsible for all expenses for conservation and repair. The mortgagor must maintain the machinery in the condition and place where it is installed at the time of constituting the mortgage, and will be subject to civil liabilities for any default in this obligation. In the event that the mortgagor does not permit the mortgagee to inspect the machinery, or in case of any undue use thereof by the mortgagor, the mortgagee may declare the debt to be immediately due and payable, and proceed to execute the mortgage.

Special Rules on Copyright and Intellectual Property

<u>Article</u>	<u>Provision</u>
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- 45 The copyrights and intellectual property rights that may be mortgaged are those established in the respective laws on these matters (see text and footnotes, *infra*).
- 46 Unless agreed to the contrary, a chattel mortgage shall be deemed to extend to (1) in the case of copyright, any adaptation, translation or other use of the copyrighted work;²³ and (2) in the case of intellectual property, any addition, modification or perfecting of the item. Likewise, any trade name is deemed to include any complementary commercial slogans.
- 47 In addition to the other obligatory mentions in the mortgage document, a mortgage on copyrights and intellectual property must include (1) nature, type and other characteristics of the items; (2) name or brief description of the invention, discovery or industrial model or design that exactly indicates its nature and purpose, or the name or description of the trademark, with an indication as to the products to which it applies; (3) date, number and other data related to the application, registration or renewal of the item; (4) any authorization or grant to third parties by the titular owner; (5) declaration to the effect that any payments related to a patent are current; and (6) declaration that the registration of any mortgaged patent or trademark has not been cancelled for any of the reasons contemplated in the intellectual property law.²⁴

²³ Article 3 of the Copyright Law (*Ley de Derecho de Autor*, published in the Extraordinary Official Gazette No. 4.638 of October 1, 1993) provides that translations, adaptations, and so forth, are deemed to be distinct works; however, in the case of chattel mortgages this separation would be overridden by Article 46 of the Chattel Mortgage Law.

²⁴ See Articles 17 and 36 of the Intellectual Property Law (*Ley de Propiedad Industrial*, published in the Official Gazette No. 25.227 of December 10, 1956).

48 A mortgagor may not renounce or assign any of its rights, in whole or in part, without the express consent of the mortgagee.

49 The mortgagee shall have the right to request any renewals or extensions, as well as to pay any fees that may be entailed, in which case the mortgagee can charge such expenses to the mortgagor in terms of Article 9 of the Chattel Mortgage Law, *supra*. Likewise, the mortgagee shall have the same rights as accorded to the owner of a patent.²⁵

50 Unless otherwise stipulated in the mortgage document, the mortgagee may declare the debt to be immediately due and payable in the event that the mortgagor does not exploit a mortgaged patent or use a mortgaged trademark for a period longer than one year.

Comparative Comments

With respect to Articles 20-50, *supra*, some comments are in order. First, in regard to Article 21, we merely reiterate the inflexibility of the relatively limited range of the types of properties that may be the subject of a chattel mortgage. This restriction is not suitable in a more diverse and dynamic commercial world. Secondly, in this same context we draw attention to the comparatively excessive detail imposed by the Venezuelan law with respect to the information that must be included in a mortgage document. While it is evident that the greater precision with respect to identifying parties, terms and conditions, and particularly the properties placed in guarantee is advisable, at the same time this degree of detail required by the law, and in view of the

²⁵ Id. Articles 92-96, and Articles 50-58 of Decision 486, Uniform Intellectual Property Code of the Andean Community of Nations (published in the Official Gazette of the Acuerdo de Cartagena, No. 600 of September 19, 2000).

tendency toward strict interpretation, if not improper favoritism or influences in judicial execution proceedings, can provide an undesirable procedural excuse to annul or diminish the legitimate rights of mortgagees.

More specifically, we note that the provisions of Article 27, with respect to a mortgage on a mercantile establishment, regarding the imperative of a purchaser to either be subrogated to the leasehold of a mortgagor or to become the lessee of a mortgagor owner of the pertinent business property, are based on concepts that presume that the purchaser may wish to take over and continue the business of the mortgagor, which may limit the interest of potential purchasers, including of the mortgagee. These obligatory rules tend to discourage potential international mortgagees from accepting a mortgage on the mercantile establishment of their obligors.

In a similar vein, the provisions of Articles 39, with respect to aircraft mortgages, and 43, regarding industrial machinery, tend to restrict the use of chattel mortgages as security rights in many cases. Regarding both of these articles, the principal problem is with respect to timing or prerequisites. In the case of aircraft, it may be noted that in order to complete the mortgage document it is necessary to include therein the tail number of the airplane and other registration data provided by the air registry, but normally some of this information cannot be finalized until the aircraft is actually in the country as it is related to the airworthiness inspection that must be conducted by officials of the civil aviation division of the Ministry of Infrastructure. Thus, while a provisional tail number can be obtained prior to the arrival of the aircraft, the only way to accomplish

the airworthiness inspection prior to importation of the aircraft is to arrange to have the Venezuelan inspectors actually go to the site abroad where the aircraft is then located. Moreover, it is the policy of the air registry to not permit the registration of the mortgage until the aircraft is actually in the country and the import duties have been paid or deferred (on the basis of a temporary importation) by the Ministry of Finance. Accordingly, this means that it is not possible under any circumstances to complete the registration of an aircraft chattel mortgage until some days or weeks after the aircraft is in the country.

A similar situation arises in the case of industrial machinery under Article 43, which requires (in clause 3 thereof) that the mortgaged machine be located in a particular building prior to the constitution of the mortgage. Accordingly, this again means that the machine must be in the country for some period, as may be required for importation, transportation and installation, before the mortgage can even be submitted (in the case of mortgagees so requiring) to the Ministry of Production and Commerce for approval and then for registration.

In both the cases of aircraft and industrial machinery, then, these rigid, obsolete rules imply that a vendor or financier of such transactions will either require some other form of security during the interim until the chattel mortgage can be duly registered (until which it is not deemed to have created a security right under Venezuelan law) or it will have to choose to be unsecured for a lengthy period. Evidently in these cases such

rigidities undermine the potential interest in creating security rights through chattel mortgages.

Provisions on Nonpossessory Pledges

<u>Article</u>	<u>Provision</u>
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| 51 | A nonpossessory pledge may only be constituted with respect to the following properties: (1) unharvested fruits and crops; (2) harvested fruits and crops; (3) all species of domesticated animals, their offspring and products deriving therefrom; (4) harvested or unharvested forestry products; (5) all machinery and implements related to agricultural, fishing and forestry activities; (6) machinery and other chattels not encompassed under Article 42 of the Chattel Mortgage Law and not related to an agricultural, fishing or forestry activity, but that may be sufficiently identified; and (7) merchandise, processed goods and raw materials. Likewise, a nonpossessory pledge may be constituted on all or part of a collection, or on individual items, of artistic, scientific or historical works or objects, such as paintings, tapestries, sculptures, arms, furniture, ceramics, books and similar items. A nonpossessory pledge may not be constituted on items covered by Article 21 of the Chattel Mortgage Law, or on items included in a real property mortgage. |
| 52 | Goods that are subject to a nonpossessory pledge may not subsequently be included in a real property mortgage, even if they are incorporated into or form a part of a subject real property. |

- 53 The nonpossessory pledge document must contain at least the following mentions: (1) full description of the pledgee; (2) full description of the pledgor; (3) principal amount of the debt that is guaranteed, expressed in national currency, interest rate, term, place and form of payment, and the amount stipulated for execution costs and expenses; (4) detailed description of the items subject to the pledge, including their nature, estimated value, quantity, condition, and distinguishing marks; (5) statement as to the ownership by the pledgor and a sworn declaration by the pledgor to the effect that they are not already subject to any encumbrance; (6) specification, if applicable, as to the building where the subject items are located, used or stored; (7) stipulation as to the obligations of the pledgor to conserve the subject items and to dispose of them for the benefit of the pledgee; (8) stipulation, if any, as to the obligation of the pledgor to insure the subject items and, if already insured, specification of the insurance policy(ies); and (9) specification of the domicile of the pledgor for purposes of service of process.
- 54 In the case of a nonpossessory pledge on live animals, the pledge document must describe a number of particulars regarding the type of animals and the registration of the symbol with which they are branded. Likewise, in the case of a pledge on cut or uncut wood, it is necessary to include a mention of the authorization to cut and transport the wood products.
- 55 For all legal purposes the pledgor shall be considered to the depositary of the pledged items, and is subject to civil and criminal liabilities and sanctions, but

without prejudice to its right to use the subject items for the purposes intended, without diminishing their value, and to undertake the measures necessary for their conservation and repair.

- 56 In the event of the death of the owner of the pledged items, the pledgee may designate another person to act as depositary.
- 57 The pledged items may not be moved from the place where they were located at the time of constituting the pledge, which must be indicated in the pledge document, without the verifiable consent of the pledgee.
- 58 Any default by the pledgor, including the misuse of the pledged items, shall give rise to the right by the pledgee to declare the debt to be immediately due and payable, and to execute the pledge, without prejudice to any other liabilities or responsibilities of the pledgor.
- 59 The pledgee shall have the right to inspect the pledged items at any time. In the event that the pledgor obstructs such inspection, the pledgee may proceed to execute the pledge and may also request a judicial inspection of the pledged items.
- 60 The provisions of Article 59, supra, shall remain in effect even if the pledgor is required, in the pledge document, to provide periodic information regarding the status of the pledged items.
- 61 In the event that the owner of the pledged items wishes to sell some or all of them, and provided that the pledgee has so consented, the pledgee shall have a first option to acquire the items to be sold, but further provided that the sales

price is less than the total amount of the outstanding debt, in which case the pledgor shall remain liable for the balance.

62 In the event that the pledged items are abandoned by the pledgor, the pledgee may declare the indebtedness to be due and payable, and the pledgee may assume the administration, preservation and custody of the pledged items, at its own risk, provided this has been contemplated in the pledge document, and further provided that the pledgee has first notified the competent court and obtained a judicial inspection of the items.

63 Any items pledged in accordance with the Chattel Mortgage Law may not also be the subject of a Civil Code possessory pledge.

64 In the event that the pledgor sells the pledged items without the consent of the pledgee, the buyer only acquires good title if it acted in good faith and has taken possession of the items. In the event that the pledgee discovers the sale prior to the taking of possession by the buyer, the pledgee may prevent the transfer of possession through an injunction to this effect or by requesting the competent court to order the deposit of the items. If the buyer takes possession subsequent to any such court order, it does not acquire good title and rather shall be deemed for all legal purposes to be a mere depositary of the items, subject to the legal obligations of a depositary.²⁶

65 Without prejudice to the provisions of Article 64, supra, the pledgee can opt to be subrogated to the rights of the buyer if within 40 days of discovering the attempted sale the pledgee pays to the buyer its purchase price and expenses, provided, however, the buyer has not resold the items in this interim.

²⁶ See Articles 1756-1772 of the Civil Code.

Notwithstanding, the buyer may opt to pay to the pledgee the full amount of the outstanding principal of the debt, plus all matured interest, in lieu of selling the items to the pledgee.

- 66 In all cases of the sale of pledged goods, including with the consent of the pledgee, on installment terms, the pledgee shall be subrogated to the right of the pledgor to collect the future amounts payable by the buyer, provided that the pledgee has duly notified the buyer of the existence of the pledge.

Comparative Comments

As may be observed, the Chattel Mortgage Law contains greater detail with respect to the constitution and operation of nonpossessory pledges than is the case for any of the model international laws, the provisions of which are rather more based on the basic principles of assuring the ease of creation and the efficacy of the secured rights accorded to the creditor. In this sense, then, the Chattel Mortgage Law is antiquated with respect to modern international practice and, moreover, the extent of specificity in the Venezuelan law both tends to limit the utility of the nonpossessory pledge and to create potential pitfalls for those who would rely on this form of security right.

Otherwise, we wish to reiterate the inconvenient requirement contained in Article 53(6), and repeated in Article 57, *supra*, that in the event that a pledged item is located in or on a real property, this location must be specified in the pledge document. Again, this means in practice that a pledge cannot be created until the item (for example, a piece of machinery) is already located at the place where it will be used. This requirement

essentially obviates the use of a nonpossessory pledge in situations in which the pledgor is purchasing a piece of machinery from abroad, as the pledgee cannot rely on such a pledge until the machinery is installed at the place of the pledgor and, of course, the pledge is registered (see *infra*).

Lastly, we call attention to the obsolete provision of Article 61, *supra*, to the effect that a pledgee is unable to acquire title to the pledged items that are to be sold unless the purchase price is for less than the value of the indebtedness. We rather suggest that in keeping with the silence in this respect of the referred to model laws, the interested parties should be at liberty to determine the value of the items involved, so that if they are equal to, or greater than, the amount of the debt then the parties should be able to so reach an agreement for conveyance.

Provisions on Registration of Chattel Mortgages and Nonpossessory Pledges

<u>Article</u>	<u>Provision</u>
78	The Chattel Mortgage Law requires all public registries ²⁷ to maintain special records on chattel mortgages and nonpossessory pledges.
79	In said records the following documents relating to chattel mortgages and nonpossessory pledges are to be registered: (1) those that constitute or modify mortgages and pledges; (2) <i>intervivos</i> assignments or transfers, as well as cancellations; (3) inheritances of credits; (4) judicial orders that affect the underlying credits or that annul the guarantee; and (5) judicial

²⁷ There are approximately 200 public or civil registries in the country where mortgages or pledges could be registered. Their jurisdiction generally coincides with one or more municipalities. By decree, the Ministry of Interior and Justice may create additional public registries.

orders regarding the annulment, rescission, cancellation or any equivalent action.

80 When a mortgage or pledge presented to a public registry indicates that it has also been registered in an administrative or commercial registry,²⁸ the public registrar shall notify, ex officio, such other registries of the existence of the encumbrance, any modifications thereof, and the cancellation thereof.

81 The registration of mortgages and pledges are subject to the following specific rules: (1) mortgages on mercantile establishments and industrial machinery are to be registered in the registry having jurisdiction over the place where the business and the machinery is located; (2) mortgages on automotive vehicles, in the registry where the ownership of the vehicles is registered, and in the case of other types of vehicles, or components, and railway rolling stock, in the registry having jurisdiction over the domicile of the mortgagor; (3) mortgages on copyrights and intellectual property are to be registered in the registry located in the capital of the country (the city of Caracas) designated by the Minister of Interior and Justice;²⁹ and (4) mortgages on aircraft, in the registry in the capital of the country designated by the Minister of Interior and Justice.³⁰

²⁸ Examples include in the cases of aircraft, which must be registered in the air registry, and of automotive vehicles, which must be registered in the national registry of vehicles, both of which are agencies of the Ministry of Infrastructure, and in the case of mercantile establishments, which must be registered in the corresponding mercantile registries.

²⁹ Registry of the Second Circuit of the Sucre Municipality.

³⁰ Registry of Third Circuit of the Libertador Municipality.

82 Nonpossessory pledges are to be registered in the corresponding public registries in accordance with the following specific rules: (1) in the case of unharvested crops and all items used for agricultural, fishing and forestry activities, in the registry of the jurisdiction where the activity is located; (2) in the case of harvested crops, merchandise, processed goods and raw materials, in the registry of the jurisdiction where they are stored; (3) in the case of live animals, in the registry with jurisdiction over the area where they are kept; (4) in the case of forestry products, in the registry of the jurisdiction where the trees are, or the activity is, located; (5) in the case of artistic, scientific and historical works or objects, as well as machinery and other chattels not related to agricultural, fishing or forestry activities, in the registry of jurisdiction over the domicile of the pledgor; and (6) if the farm or ranch lies in more than one jurisdiction then registration shall be effected in all such jurisdictions. In the cases of (1), (3) and (4), if the pledgor were the owner of, or has any registered title to, the related real property, then a marginal note is to be inserted in each such property registry.

83 In the event of both a chattel mortgage and a nonpossessory pledge, separate annotations are to be made in the same record.

84 The registrations of mortgages and pledges are available to the public and any interested party may obtain certified copies thereof.

- 85 The registrations of a chattel mortgage and of a nonpossessory pledge shall expire, and shall be cancelled ex officio, after six and four years, respectively, from the date of expiration of the guaranteed obligation.
- 86 All matters regarding registration not expressly governed by this section of the Chattel Mortgage Law shall be governed by the Public Registry Law.³¹ Specifics regarding the form of annotations and other particulars may be the subject of regulations to this law or they may be determined by resolution of the Minister of Interior and Justice.

Comparative Comments

There are several noteworthy differences between the publicity and registration provisions of the Chattel Mortgage Law and the international model laws. Whereas the model laws provide for a central registry, in the case of the Chattel Mortgage Law this is only established in the cases of aircraft, and copyrights and intellectual property. Except for these forms of property, and in the cases of automotive vehicles, ships and privately-owned arms, Venezuela does not have national registries. Accordingly, anyone wishing to verify the existence of a security right on any other type of property under the Chattel Mortgage Law must check at one or more registries potentially in any of the approximately 200 registry jurisdictions in the country. In addition, there is no possibility of electronic filing or consultation of registry records, as is contemplated in the UNIDROIT Convention and the Inter-American Law. Moreover, in the case of the Chattel Mortgage Law the mortgage and pledge documents that must be filed in order to

³¹ Decreto No. 1554, Decreto con Fuerza y Rango de Ley de Reforma Parcial de la Ley de Registro Público y Notariado, published in the Official Gazette No. 37.324 of November 14, 2001.

perfect the guarantee require the presentation of relatively lengthy and detailed descriptions of the terms of the guarantee, and of the property subject to the guarantee; in contrast, the model laws require only the completion of fairly short and simple forms, and do not require the presentation of the contract constituting and describing the guarantee.³²

However, one of the principal disincentives to the use of the Chattel Mortgage Law is the cost of registering a mortgage or pledge, without which registration the guarantee is not perfected. In accordance with the Public Registry Law, the fee for registering a mortgage or pledge is 0.25% of the total amount thereof,³³ which compared to the fees anticipated to be charged by the central registries under the model laws represents an excessive cost.

Execution of a Chattel Mortgage and Nonpossessory Pledge

General Rules

Article

Provision

- 67 The execution of chattel mortgages and nonpossessory pledges is to be governed by the norms of the Chattel Mortgage Law, without prejudice, however, to the general norms of civil procedure.
- 68 In the event that a third party sues the mortgagor or pledgor and a court issues an attachment or execution order with respect to items that are the subject of a

³² See, generally, Title IV of the Inter-American Law, Chapters IV and V of the UNIDROIT Convention, and Schedules 1 and 2 of the EBRD Law.

³³ This fee is based on Article 129(1) and (2) of the previous version of the law (Decree No. 362, published in the Extraordinary Official Gazette No. 5.391 of October 22, 1999), as the new fee structure contemplated in the current law has not yet been established. By way of example, the cost of registering a chattel mortgage with a value of US\$1 million is US\$2,500, plus other minor notarization and tax stamp costs.

mortgage or pledge, such orders shall have no legal effect and the underlying debt of the mortgagor or pledgor shall be deemed to be immediately due and payable. The mortgagor or pledgor is obligated to inform the court of the existence of the mortgage or pledge, and the court is then obligated to inform the mortgagee or pledgee. If the mortgagor or pledgor fails to so advise the court, it shall incur the criminal penalty contemplated in the Criminal Code.³⁴

Execution Procedure for a Chattel Mortgage

<u>Article</u>	<u>Provision</u>
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69	In the event that the parties did not designate a jurisdiction for execution, the competent court, by virtue of the amount involved, of the jurisdiction where the mortgage was registered shall have jurisdiction. If the mortgage was registered in different jurisdictions, then the competent court of any such jurisdiction may hear the case.
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70	According to the provisions of the Chattel Mortgage Law, the execution of a chattel mortgage is supposed to be an executory procedure based on the following: (1) the mortgagee is to file a suit for execution in accordance with the requirements of the Code of Civil Procedure, ³⁵ accompanying the suit by the documents evidencing the mortgage and a certified copy of the registration(s); (2) in the same decision of the court admitting the complaint the court is to order the mortgagor to pay the debt within eight days and the court is to order the sequestration of the subject property; (3) if a third party is
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³⁴ Article 464 of the Criminal Code, supra note 9, provides for incarceration of from one to six years.

³⁵ Supra note 8, Articles 660 to 665.

in possession of the subject property, it is deemed to be notified on the date of sequestration; (4) if the mortgagor has not paid within the eight-day period, the court will order a public auction of the subject property based on the minimum price therefor established by the parties or as determined by an appraiser appointed by the court, upon the petition of any interested party or ex officio by the court; (5) in the public auction all bidders must deposit with the court at least 10% of the minimum price, except that the mortgagee may enter a bid without having to make a deposit; (6) if there are no bids that meet the minimum price, then the mortgagor may purchase the property for the minimum price; (7) in the event that the mortgagee does not avail of the option established in (6), supra, any of the interested parties may request the court to proceed to a second auction using as a base price one-half of the initial minimum price; (8) if there is still no bid that satisfies the reduced minimum price in the second auction, the court may order as many subsequent auctions as requested by any of the parties, in which case there shall be no minimum price; (9) if there is a successful bidder, it must pay the difference between its deposit and the purchase price within three days, under penalty of losing the deposit, but if the resulting purchaser were the mortgagee and it does not proceed to acknowledge the corresponding cancellation or reduction of the debt, the mortgagor may request the court to effect this by way of execution of a judgment; (10) upon the completion of the auction process the court will order the cancellation of the mortgage and all registrations; (11) the sum received from the auction shall be applied to pay the indebtedness and all

execution expenses, with any remainder being delivered to the mortgagor; but (12) in the event that the proceeds of the auction are insufficient to satisfy the amounts due to the mortgagee, it shall preserve its claim against the mortgagor for the balance.

71 The execution procedure stipulated in Article 70, supra, shall not be suspended due to the death, bankruptcy or incapacity of the mortgagor, nor due to legal actions initiated by any of the parties or by any third party, except in the following cases: (1) if the defendant duly demonstrates that the debt was paid, the term thereof was extended, or the mortgage was cancelled; (2) if a third party demonstrates that it was the lawful owner of the subject property prior to the constitution of the mortgage; (3) if a criminal fraud action based on false allegations as to the ownership of the subject property were initiated prior to the commencement of the enforcement suit; and (4) if it is demonstrated, based on prior registrations, that the subject property was the object of any other existing encumbrance prior to the constitution of the mortgage. The suspension of the execution shall continue until the foregoing actions are resolved, except that if they involve only part of the mortgaged property, the execution is to continue with respect to the remainder.

72 The court decisions with respect to the executory procedure for the execution of a mortgage, as established in the preceding articles, do not have the effect of a final judicial sentence with respect to the underlying substantive issues between the parties. Accordingly, at any stage, and up to three months following the conclusion of the execution of the mortgage, any of the parties

may initiate an ordinary civil suit with respect to any related rights and damages, but which action does not serve to suspend the execution of the mortgage.

- 73 The execution of a mortgage may not be joined with any other action and all appeals that may be permissible in accordance with the Chattel Mortgage Law and the Code of Civil Procedure shall only refer to matters arising in the context of the execution.

Execution Procedure for a Nonpossessory Pledge

<u>Article</u>	<u>Provision</u>
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| 74 | The procedure for executing a nonpossessory pledge is essentially the same as in the case of chattel mortgage, as established in Article 70, supra, with the following exceptions: (1) none of the potential bidders is required to post a deposit in order to participate in the auction; (2) a successful bidder must immediately, in the same auction process, pay the full amount of the purchase price and if it does not, the auction process is continued; and (3) if there are no bids that satisfy the minimum price, then the pledgee can request the court to convoke a second auction in which case there shall be no minimum bid price. |
| 75 | This article essentially repeats the provisions of Article 71, supra. |
| 76 | This article repeats the provisions of Article 72, supra. |
| 77 | This article repeats the provisions of Article 73, supra. |

Comparative Comments

With respect to the provisions of the Chattel Mortgage Law regarding the execution of chattel mortgages and nonpossessory pledges, the principal criticism is with respect to the efficacy of the procedure contemplated by the legislators, that is that it is an executory procedure providing assurance to creditors that their security rights will be promptly enforced. However, undermining this objective are the provisions of Articles 71-73 and 75-77, respectively, the effects of which, together with the generally weak judicial system of Venezuela,³⁶ permit in practice that defendants not wishing to comply with their contractual security obligations can delay the effective enforcement, in terms of timeliness, costs and other inconveniences, far beyond the short periods contemplated by an executory procedure. To a large extent, evidently, this is as much a problem of the judicial system and the legal culture of the country as it is of the specific enforcement provisions of the Chattel Mortgage Law, but regardless the effect is to diminish the reliability of even this somewhat restrictive scheme of security rights.

Additionally, the provisions of the Chattel Mortgage Law regarding enforcement differ to a considerable extent from the norms of the model laws referred to herein. Most significantly, the only way to enforce a chattel mortgage or nonpossessory pledge in Venezuela, and under the Venezuelan law, is through a judicial proceeding; there are no self-help remedies contemplated or permitted. While the model laws do not exclude, of course, resort to the courts for obtaining possession of the subject property, delineating the rights of competing security guarantees, certain dispositions, and so forth, in contrast all of the model laws contemplate the possibility of direct action by the creditor, when

³⁶ In comparative terms, the Venezuelan judiciary has been characterized by judges who do not represent the highest juridical standards, procedural inefficiency and lengthy delays, among other systemic defects.

and as feasible, to take possession of the subject property, to sell or lease it, to acquire ownership of it and, generally, to exercise the remedies that tend to fulfill the object of the security right without, at the same time, relieving the creditor of its obligation to treat the mortgagor or pledgor fairly, and without prejudice to any rights of the mortgagor or pledgor. The model laws also, explicitly and implicitly, emphasize efficacious and expedient enforcement methods and procedures, in recognition of the interest of creditors to not have their funds or their assets unduly kept out of the marketplace.³⁷ Nevertheless, it must also be noted that the provisions of the model laws are to be compatible with national legislation and practices, which may not assure the full application of the ideal principles established in the model laws.

CONDITIONAL SALES LAW

The 1959 Conditional Sales Law is quite brief and its provisions reflect the commercial climate of its epoch rather than the conditions of modern commerce of capital goods and financial practices. Its principal terms are the following:

<u>Article</u>	<u>Provision</u>
1	This law covers installment sales in which the vendor retains title to the good until it has been fully paid for. The purchaser obtains title upon the final payment, but assumes all of the risk associated with the good from the time of possession. In the event that the vendor assigns the underlying credit, the assignee also receives title to the good.

³⁷ See generally Articles 24 and 25 of the EBRD Law, Chapter III of the UNIDROIT Convention, and Title VI of the Inter-American Law.

- 2, 3 The provisions of these articles are described in footnote 6, supra.
- 4, 5 These articles provide, first, that any item sold under a conditional sales agreement must be specifically identified. Additionally, the conditional sales agreement must fully identify the parties, the place where the good is to remain during the term, the sales price, date of the sale, and payment terms. The agreement must be notarized.
- 6 Independently of a guarantee as to serviceability, the vendor is deemed to guarantee the existence during the term of replacement parts, and technical and maintenance services.
- 7 When the purchaser acquires title to the good, whether by virtue of making full payment or for any other legal reason, the vendor is to verify this fact, but if the vendor does not do so then the final receipt or proof of payment shall suffice.
- 8 The purchaser must notify the vendor if it moves to a different location and in the case of any judicial attachment or execution order affecting the good. If the purchaser does not do so, the vendor may proceed to execute the contract.
- 9 The purchaser may not sell the good during the term of the contract. If it does so, aside from the corresponding criminal penalties, the vendor may proceed against the third-party buyer, subject to the provisions of Article 14 (see infra), to repossess the good, or the vendor may sue the third-party buyer to collect the balance of the purchase price.
- 10 A conditional sales agreement may not have a term of over five years.

- 11 A third-party buyer who acquires the good in a public sale or at a judicial auction shall only be obligated to return the good to the vendor once said buyer's expenses have been reimbursed.
- 12 If the good is lost or damaged, the vendor shall acquire the rights of a pledgee with respect to any insurance indemnization.
- 13 Regardless of any contractual stipulation to the contrary, until and unless the purchaser defaults in the payment of installments that are valued at more than one-eighth of the purchase price, the sole remedy of the vendor is to sue the purchaser for the payment of said unpaid amounts, plus the interest thereon; once paid, the purchaser maintains the right to make future payments.
- 14 If the conditional sales contract is rescinded due to the default of the purchaser, and the vendor repossesses the good, the vendor must return to the purchaser the installment amounts paid by the purchaser, less a "just compensation" for the use of the good, plus any damages caused to the vendor. If the parties contractually agreed that in this case all of the amounts paid by the purchaser are to be kept by the vendor, and provided that the purchaser had paid over one-fourth of the purchase price, the court may reduce the compensation claimed by the vendor.
- 15 In case of default by the purchaser, if the repossessed good has increased in value, the increment shall be for the benefit of the vendor.

- 16 The privileges established in the Civil Code for a lessor of premises where a sold good is located, in relation to the collection of rents, shall not extend to any benefits deriving from said good.³⁸
- 17 If the purchaser is declared bankrupt, this is cause for the rescission of the contract.
- 18 Notwithstanding Article 17, the mass of creditors of the purchaser may opt to purchase the good by immediate payment of the balance due.
- 19 The statute of limitations for actions by the vendor against third parties is six months from the date of the last unsatisfied payment.
- 20 Both the vendor and the purchaser can oppose an attachment order affecting the good resulting from a suit by the creditors of either by presenting the conditional sales agreement.
- 21 Regardless of the amount at issue, any suit on a conditional sales agreement is to be resolved based on the executory procedure contemplated in the Code of Civil Procedure.
- 22 When the vendor brings an action against the purchaser requesting the repossession of the good the court may order that the good be sequestered, provided that the vendor constitutes a bond sufficient to assure the redelivery of the good to the purchaser, plus its damages, in the event that the vendor does not prevail in the action. Prior to any order of repossession the court must effect a judicial inspection to verify the condition of the good and order an appraisal of the good, which shall serve as the basis for any amounts to be eventually settled between the parties.

³⁸ Article 1871(4).

Comparative Comments

There are various aspects of Venezuela's Conditional Sales Law that make this law unsuitable as a tool for creating security rights in the context of modern, and especially, international commerce. Moreover, to the extent that the model laws referred to herein encompass the concept of conditional sales, their essential principles contrast significantly with the antiquated norms of the Venezuelan law.

The provisions of the Conditional Sales Law that are perhaps the most disconcerting for a potential creditor vendor are those contained in Articles 13 and 14. In the case of the former, which provides that a vendor may not sue to repossess the good until the purchaser has defaulted in payments worth more than one-eighth of the purchase price, this potentially places a burden of high risk on the vendor in that it must either suffer the possibility of delays in being able to take measures to secure and repossess the good or, as one alternative, to divide the payment schedule into eighths. Then, under the provisions of Article 14, the creditor vendor is placed in the uncertain position of possibly having a Venezuelan court reduce the amount of the indemnity that may have been contractually agreed upon between the parties, if they had agreed to permit the vendor to retain the amounts paid and these exceeded one-fourth of the purchase price at the time of default. While the parties and the drafters of their agreement may attempt to overcome this potential negative inducement for the vendor, the latter cannot be assured that a court will uphold the benefit to it of the agreement.

Another inconvenient provision in the Venezuelan law is that contained in Article 6, which places the burden of guaranteeing spare parts and technical maintenance services on the vendor rather than on the purchaser. This places the vendor in the position of a lessor of a chattel and defeats the principle of caveat emptor, as if the purchaser should not take responsibility for knowing what it is buying.

Other unattractive provisions, from the perspective of a creditor vendor, are the arbitrary maximum term of five years (Article 10), the restricted scope of goods that may be sold under a conditional sales agreement (Articles 2 and 3), and the provisions of Article 11, to the effect that a third party buyer in a public sale or judicial auction is only required to give up possession upon reimbursement of its costs and expenses. While the latter provision can be, to some extent, protected against by making the original purchaser liable for such damages, this places a burden on the vendor to be vigilant as to the status of its good, as well as to then have to seek monetary restitution from its purchaser who may under such circumstances be in financial difficulties. Again, all of these approaches of the Venezuelan law contrast negatively with the model laws, which are oriented toward protecting the security rights of the creditor with the objective of encouraging, rather than discouraging, international credit and, thus, trade and development.

Lastly, we would point out the unsuitable provisions of Article 22, which contrast negatively with even the enforcement provisions of the Chattel Mortgage Law. Under Article 22 a vendor seeking to repossess the good to which it has title may only petition

the court to in its discretion sequester the good in question, which may be denied, but adding insult to injury, if the court agrees to order the sequestration of the good it can only do so provided the vendor posts a bond sufficient, again in the discretion of the court, to indemnify the purchaser for the removal and/or loss of use of the good in the event that the vendor does not prevail in the repossession action. Evidently, these provisions with respect to enforcement offer little comfort to an international vendor that would like to be assured of the prompt and effective recovery of its good, plus whatever damages it may have incurred, in the event of a default by its purchaser.

POSSESSORY PLEDGES

Venezuelan law contemplates traditional possessory pledges under both the Commercial Code and the Civil Code.³⁹ In both cases, of course, the essential element, aside from the formality of having a written document that expresses the basic elements of the transaction, is that the debtor must have delivered possession of the subject property to the creditor or to a mutually agreed depository. Under the possessory pledge the creditor is responsible for the care and maintenance of the property serving as the security right, although the creditor is entitled to be reimbursed for any such expenses. The possessory pledge gives the creditor a priority right over other creditors with respect to the value of the subject property, without prejudice to such privileges as are established by law.⁴⁰ The creditor may retain possession of the property placed in

³⁹ See, generally, Articles 535-543 of the Commercial Code (Código de Comercio, published in the Extraordinary Official Gazette No. 475 of December 21, 1955) and Articles 1837-1854 of the Civil Code.

⁴⁰ The traditional privileges are stipulated in Article 1870 of the Civil Code, although others may exist under special laws.

guarantee until such time as the debt is fully paid. However, the creditor may not use or dispose of the property and a possessory pledge only gives the creditor the right to have the subject property sold through a judicial auction following the initiation of an execution action in the corresponding court, with the proceeds of such sale then applied to the indebtedness. A quasi-possessory pledge may be created in the case of one who performs some form of work on a chattel and then is entitled to retain possession of it until said service is compensated.⁴¹ Because of the inconvenience of having to take possession, possessory pledges are a little used form of security right in the case of tangible goods, although they are commonly used in modern securitization practice with respect to financial instruments, shares of stock in companies, and other forms of incorporeal property notwithstanding the same kinds of uncertainties and delays of enforcement as referred to with respect to Venezuela's other forms of security rights.

SHIP MORTGAGES

Of all of the Venezuelan legislation creating security rights of the nature most generally contemplated by UNCITRAL and the model laws referred to herein, the norms on ship mortgages and related privileges most approximate the provisions and spirit of these modern concepts. In part this is due to the recent promulgation (2001) of the current version of the Law of Maritime Commerce,⁴² which contains these norms, and in part because of the desire of Venezuela to wish to encourage international financing in

⁴¹ Article 1647 of the Civil Code.

⁴² The Law of Maritime Commerce (supra note 5) repeals the previous Maritime Law on Privileges and Mortgages of 1983, as well as various articles of the Commercial Code relating to maritime matters, which date back to 1873 (see the First and Second Revocation Provisions).

order to modernize its merchant marine fleet.⁴³ Hence, even though this is a specialized law applying only to maritime vessels, the provisions on ship mortgages, and to a lesser extent related privileges, merit a more detailed discussion.

Ship Mortgages

<u>Article</u>	<u>Provision</u>
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| 130 | Ships may be the subject of a chattel mortgage. Mortgages take effect as such once registered in the Venezuelan Maritime Registry, ⁴⁴ where all modifications and cancellations must also be registered. |
| 131 | Ship mortgages may be constituted abroad, in which case they shall be governed by the law of the foreign jurisdiction. However, to be enforceable in Venezuela they must be registered in the Venezuelan Maritime Registry, the mortgage document must conform to the informational requirements of the Law of Maritime Commerce, and they must fulfill other formalities, such as notarization and legalization (apostille). |
| 132 | In order for mortgages or other encumbrances on foreign ships to be recognized in Venezuela they must (1) be duly registered in a public registry in accordance with the foreign law, (2) said registry must be available for public scrutiny, and (3) the registered document must at least contain information regarding the mortgagee, the amount of the mortgage, and other particulars with respect thereto, including the priority of the mortgage in accordance with the foreign law. |

⁴³ See the Exposition of Motives of the Law of Maritime Commerce.

⁴⁴ The Venezuelan Maritime Registry is an agency of the National Institute of Aquatic Areas, which is a division of the Ministry of Infrastructure.

- 133 This article details the minimum information that must be contained in a ship mortgage, including, inter alia, identification of the parties, identification of the ship, extension of the mortgage to include the cargo and any other indemnification (e.g. insurance proceeds, etc.), and details on the credit being guaranteed.
- 134 The ship mortgage obligatorily extends to include all items related to the permanent operation thereof, including spare parts, that cannot be separated from it without altering the ship or its intended function.
- 135 Provided that at least a third of the budgeted cost has been paid, a ship mortgage may be constituted on a ship under construction.
- 136 In the case of a ship under construction, the mortgage shall extend to all materials and equipment located at the dry dock even though they have not yet been incorporated, provided that they can be identified individually.
- 137 More than one ship mortgage may be constituted on a ship, in which case priority as between mortgagees shall be determined by the date and hour of registration in the Venezuelan Maritime Registry.
- 138 Ship mortgagees have the right to petition for a judicial auction of the ship even though title thereto has passed to a third party acting in good faith.
- 139 With the exception of claims for repair costs, a mortgagee shall be subrogated to claims of the mortgagor for damages caused to the ship and to insurance proceeds.
- 140 The mortgagee may seek to execute the mortgage against the ship in any of the following circumstances: (1) default in payment of the principal of the

obligation at maturity, (2) default in payment of interest due, (3) if the mortgagor is declared bankrupt, (4) if the ship ceases to be navigable, (5) any other default under the mortgage, and (6) when more than one ship is subject to the same mortgage and any one of them is lost.

- 141 In the case of any event of default as stipulated in Article 140 the mortgagee shall have the right to take possession of the ship and to commercially operate it, in which case the earnings so derived shall be applied first to contractual interest, then to expenses and lastly to the amortization of the principal of the credit.
- 142 Once in possession of the ship, the mortgagee shall be responsible for it, including in the case of force majeure.
- 143 If the mortgage document so provides, the mortgagee may, upon the default of the mortgagor, proceed to the direct sale of the ship. If this was not contemplated in the mortgage document, the mortgagee may seek to have the ship sold via judicial auction.
- 144 If there was more than one mortgage on the ship and a mortgagee proceeds to a direct sale, the proceeds thereof must be consigned to the competent court, which shall distribute the funds according to the rights of the parties.
- 145 In order to obtain possession of the ship, the mortgagee may petition the competent court to attach the vessel, following which it shall be delivered to the mortgagee.
- 146 In order for a second or subsequent mortgagee to be able to proceed with the direct sale of the subject ship it is necessary to obtain the consent of all

mortgagees, absent which said second or subsequent mortgagee can only sue for execution of its mortgage and the judicial auction of the ship.⁴⁵

Privileges in Relation to Ship Mortgages

The special norms with respect to privileges in relation to ship mortgages are contained in Articles 113-129 of the Law of Maritime Commerce. In summary, the most significant of these establish, first, that these specific privileges take precedence over any general or special privileges stipulated in any other law (Art. 113). Except in the case of judicial execution, these privileges apply to the ship even if it is not registered or if there is a change of ownership, registration or flag (Art. 114). The principal privileges are the following: (1) salaries and other benefits payable to the crew, including repatriation to their home base; (2) indemnification for death or injury in relation to the operation of the ship; (3) compensation for salvage operations; (4) all harbor and port charges; and (5) all damages arising from the illegal operation of the ship (Art. 115). Articles 116 and 117 establish special exclusions (in the case of sea transport of hydrocarbons and toxic substances covered by special laws and obligatory insurance, etc.) and rules regarding priority among privileged claimants. The statute of limitations on privileged claims is one year (Art. 118). Privileged creditors are not subrogated to insurance claims of the ship owner (Art. 121). Articles 122-127 deal with the judicial enforcement of these privileges and the corresponding auction of the ship. Article 128 creates a common law possessory pledge in favor of a party that constructs or repairs a ship, except that any privileged claimant specified in Article 115 or a mortgage on the ship registered prior to

⁴⁵ The final two articles on ship mortgages, Articles 147 and 148, stipulate that these special norms shall be supplemented by the general norms on mortgages contained in, especially the Civil and Commercial Codes, and that judicial procedures are to be in accordance with the provisions of the Code of Civil Procedure.

the registration of the possessory pledge shall have priority, which shall also generally apply to ships under construction, alteration or repair (Art. 129).

Comparative Comments

The rules governing ship mortgages established in the Law of Maritime Commerce represent a significant advance with respect to security rights over the restrictive and somewhat archaic norms of the other Venezuelan laws in this area and, further, closely resemble the principles of the several model laws cited herein. Among the more modern concepts of the ship mortgage are the express acceptance of foreign mortgages governed by foreign law (Art. 131; all of the other forms of security rights referred to in this chapter are exclusive to Venezuelan law and jurisdiction); the acceptance of multiple mortgages on the same ship (Art. 137; the Chattel Mortgage Law, as well as the traditional forms of pledge, expressly exclude multiple security rights over the same property); the security rights of a ship mortgagee are protected even vis a vis a good faith acquirer (Art. 138); defaults are liberally defined (Art. 140); a ship mortgagee may obtain possession of and operate the ship for a profit, applying the gains to the amortization of the debt until total satisfaction, upon which the ship is to be returned to the owner (Art. 141); and a ship mortgagee can directly sell the ship without necessarily having to go through the procedure of a judicial auction. At the same time, however, the law contains one somewhat arbitrary provision (Art. 135 requiring that one-third of the estimated cost of construction has to have been paid before the builder can obtain a ship mortgage) and enforcement is dependent on the frequently inefficient and unreliable Venezuelan judicial system.

FINANCIAL LEASES

The only norms on financial leasing in Venezuela are contained in its banking legislation (“General Bank Law”).⁴⁶ This means in practice that in order to be recognized as a financial lease under Venezuelan law, with the security rights that accord to the financial lessor, this type of operation is limited to Venezuelan financial institutions duly licensed by the Superintendency of Banks. Accordingly, foreign financial lessors or non-domiciled financial institutions may not engage in financial leasing operations in Venezuela and be assured of having their rights enforced as stipulated under the corresponding legislation of their home jurisdictions. For this reason, any international financial lessor wishing to engage in a financial leasing transaction with a Venezuelan lessee either must undertake a back-to-back transaction with a domestic financial institution or resort to a more complex dual-tier structure, usually involving a financial lease in an accommodating foreign jurisdiction and then a standard operating lease (with no purchase option at this level) between such foreign jurisdiction and the Venezuelan lessee.

The substantive norms on financial leasing are established in Articles 120-123 of the General Bank Law. In essence, these define a financial lease as an operation whereby the financial lessor acquires a chattel or a real property selected by the financial lessee that receives such property for its use during a determined period in exchange for a periodic payment that covers the amortization of the purchase price, plus all interest,

⁴⁶ Supra note 11.

commissions, and so forth of the lessor. Financial leases are to include an option in favor of the lessee, which may be exercised during the term or at maturity, to return the property, exchange it for another item or to acquire title to it, as established in the lease. Moreover, financial leases are not deemed to be installment sales when they stipulate, at any time, the obligation of the lessor to transfer title to the property to the lessee (Art. 120).⁴⁷ In the event of default by the lessee, the lessor has the right, through judicial action, to recover the subject property and to then sell or assign it to another party (Art. 122). And, the risk of possession and use of the subject property are the exclusive responsibility of the lessee (Art. 123).

Comparative Comment

There is no justification, in our view, to restrict financial leasing transactions solely to domestic financial institutions. Financial leases are evidently a widely used commercial finance vehicle supported by express legislation in most of the world's major trading nations which, moreover, do not restrict this form of commercial practice to only licensed financial institutions. Accordingly, it would behoove Venezuela to adopt norms to permit non-banking entities to engage in financial leasing, as well as to expressly allow the enforcement of foreign-law financial leases in the Venezuelan courts, just as foreign-law mortgages may be enforced in the Venezuelan courts under the Law of Maritime Commerce.

⁴⁷ This provision is essential to the concept of financial leasing as Article 1579 of the Civil Code stipulates that as a general principle of law any lease arrangement in connection with which the lessor is obligated at some point to transfer title to the leased good to the lessee is deemed to be an installment sale rather than a lease. Accordingly, a financial lessor other than a Venezuelan-licensed financial institution would risk having a court declare the presumed financial lease to be merely an installment sale, thereby entitling the creditor to only be able to sue the debtor for the unpaid installments. It is the absence in Venezuela, then, of any other legislation regulating the concept of financial leasing that restricts this form of security right to Venezuelan financial institutions.

PUBLIC USE DOCTRINE

A note of caution needs to be added to this discussion on security rights under Venezuelan law, which is with respect to the possible application of the so-called public use doctrine that could operate to partially frustrate or delay the prompt and effective (with the caveats noted on Venezuelan enforcement procedures) enforcement of security rights in the case of subject properties that are deemed by the Office of the Attorney General (*Procuraduría General de la República*) to be used to provide a public service. Such a situation could arise particularly with respect to commercial aircraft and ships, but it could also arise in the case of key machinery or equipment, for example, in basic industries from hydrocarbons to milk.

The Law of the Attorney General of the Republic⁴⁸ stipulates that when any provisional or definitive judicial measure (such as of attachment, sequestration or execution) is ordered with respect to an item of property belonging to state or private entities that is related to “public use, a service of public interest, an activity of national public purpose or a private service of public interest” the court, prior to the execution of any such measure, must notify the Office of the Attorney General. Said office then has a period of 45 days, during which the judicial proceeding is to be suspended, in which to determine if the proposed measure against the subject good would sufficiently disrupt the public purpose or service. In the event of an affirmative determination, the Office of the

⁴⁸ Decreto con Fuerza de Ley Orgánica de la Procuraduría General de la República, published in the Extraordinary Official Gazette No. 5.554 of November 13, 2001; see Article 97 of this law.

Attorney General will order the court not to act to remove the good from the public service and rather to assist the parties to find an alternate solution, such as would be common in a bankruptcy workout.

FINAL COMMENTS

With the sole exception of the modern Law of Maritime Commerce, which expressly contemplates foreign-law ship mortgages, all other forms of security rights, in order to be deemed to be such by the Venezuelan courts, must be constituted under, and in accordance with, Venezuelan law. Accordingly, potential financiers are faced with the choice of relying on one, or a combination of, the types of securitization schemes and/or other forms of guarantee offered by Venezuelan law or requiring, whenever feasible, that their Venezuelan debtors constitute security rights in their favor on assets existing or arising abroad in one or more jurisdictions that offer more amenable legislation or that provide greater comfort regarding timely and effective enforcement. Although in situations in which Venezuela does permit the use of foreign law to govern the relations between commercial parties (as is the case for most mercantile contracts) it follows generally customary international conflicts of laws rules, nevertheless in those instances when Venezuela does have express legislation on a particular subject, as is the case regarding the forms of security rights described in this chapter, said norms are deemed to be public policy and, therefore, are not subject to omission or modification by contractual convention. It is evident, then, that if Venezuela wishes to encourage internationally financed trade transactions for, particularly, its productive sectors (as it has indicated in

the maritime area), it will have to give attention to modernizing its legislation with regard to offering acceptable forms of securitization compatible with international practice, as well as to improving the transparency and reliability of its judicial system.