

## Venezuela Restructuring: A Long Road Ahead?

***Venezuela's initiative is unlikely to set the stage for a restructuring of international obligations in the face of US sanctions.***

### Key Points:

- US sanctions will prohibit US persons from engaging in a restructuring of Venezuela and PdVSA debts that includes the issuance of “new” long term debt.
- Creditors should expect that enforcement action will follow a default. The outcomes of that enforcement action will affect all stakeholders, whether or not they participate.

### Restructuring Announcement

On November 2, 2017, President Maduro of the Bolivarian Republic of Venezuela announced the creation of a presidential commission, headed by Vice President El Aissami, for the “refinancing and restructuring” of Venezuela’s external debt, estimated at between US\$100-150 billion.<sup>1</sup> Foreign creditors have been invited to a meeting on November 13, 2017 in Caracas with Mr. El Aissami to start negotiations.

On November 3, 2017, the government of Venezuela announced its “absolute and responsible commitment to continue upholding the obligations [of Venezuela and Petróleos de Venezuela, S.A. (PdVSA)].”<sup>2</sup> At the same time, PdVSA reported that it had executed a payment of US\$1.1 billion due on the PdVSA 2017 bonds, although whether that payment has been received as of the publication of this *Client Alert* remains unclear.

Following the imposition of US sanctions on Venezuela (described below), oil exports to the US have declined, and Venezuela has increased exports to China and Russia, which have provided financing to Venezuela under bilateral arrangements, including through forward sales of oil. According to recent reports, Venezuela owes China and Russia at least an estimated US\$60 billion under such arrangements.<sup>3</sup> China and Russia are therefore expected to play a key role in any restructuring of Venezuela’s external debt.

Venezuela and its instrumentalities, PdVSA and Electricidad de Caracas, continue to face material payment obligations in the near term to avoid default, with grace periods for missed interest payments in the aggregate amount of roughly US\$780 million beginning to expire in November and early December 2017.

To what extent Venezuela and its instrumentalities can and will avoid payment default on their respective bond and other obligations remains unclear.

Under present circumstances, stakeholders should expect that any payment or other defaults may lead to enforcement action shortly following such defaults.

## **Enforcement Action Against Venezuela and its Instrumentalities**

Whether enforcement action is undertaken by bondholders (following a default and acceleration) or by an arbitration creditor, the first step in any enforcement action will be obtaining a judgment on the debt in New York (or elsewhere). Following entry of a judgment, creditors may pursue execution on assets in the relevant jurisdiction. In New York, creditors may also pursue broad post-judgment discovery on assets that could be subject to execution and/or seek restraining orders to freeze assets. Such restraining orders may be served on entities in possession of the judgement debtor's property. Judgment creditors will have the opportunity to seek out assets and pursue recognition of a New York law judgment in other states in the US and in other countries. Recognition of a New York judgment in other countries will be facilitated through bilateral treaties between the US and a wide range of other countries.

Whether oil exports will be a viable target for enforcement action as assets of Venezuela, PdVSA, or their affiliates following entry of a judgment remains unclear. If title to oil in transit changes hands at ports in Venezuela, the oil may be taken outside of the scope of enforcement action in any jurisdiction other than Venezuela.

Nevertheless, bank accounts, receivables (including oil receivables), and equity in subsidiaries organized outside of Venezuela may become subject to execution, depending on the location of such assets. Creditors should note, however, that the equity of CITGO Holding, Inc. appears to be subject to security interests in favor of the PdVSA 2020 bonds and ROSNEFT Trading, S.A.. Enforcement against such equity interests will be subject to, among other things, preexisting valid, perfected, and enforceable liens.

Even if an asset is identified in a jurisdiction that grants a judgment, creditors should expect that Venezuela and its instrumentalities will seek to protect their assets on the basis of the Foreign Sovereign Immunities Act (in the US) and analogous laws of other nations that protect sovereign assets from seizure by creditors. These sovereign immunity laws typically include exceptions that may permit seizure of assets, even sovereign-owned assets, depending on the nature of the asset and how it is used.

In sum, enforcement action against Venezuela and its instrumentalities is likely to involve New York courts, and following the entry of a New York judgment, proceed in multiple jurisdictions wherever assets can be located.

New York law judgments may eventually lead Venezuela, PdVSA, and their instrumentalities to avoid transacting in US dollars, so as to avoid their accounts and receivables passing through US financial institutions that could be subject to enforcement action.

## **Impact of US Sanctions**

US sanctions will continue to significantly hamper Venezuela's ability to consummate a debt restructuring. These recently imposed sanctions prohibit US persons from transacting in, providing financing for, or otherwise dealing in "new debt" (*i.e.*, debt issued after August 24, 2017) of longer than 30 days maturity with the government of Venezuela, any political subdivision, agency, or instrumentality of the Venezuelan government, including the Central Bank of Venezuela, and any person owned or controlled by, or acting for or on behalf of, the government of Venezuela. US sanctions allow a separate debt maturity period of 90 days for PdVSA.

The term "US person" includes (a) entities organized under US law and their foreign branches, (b) US nationals and US lawful permanent residents (wherever located), and (c) any person (regardless of nationality) present in the US. The prohibition against "dealing" in new debt extends to all financing that supports such new debt, as well as the provision of services supporting such new debt. The latest

developments in the sanctions regime are described in Latham's recent *Client Alert* [The Trump Administration's New Venezuela Sanctions: Top 10 Takeaways](#).

Absent a specific or general license from the US Department of the Treasury's Office of Foreign Assets Control (OFAC), which can take months to obtain following submission of a request, US persons are generally barred from engaging in any restructuring of Venezuela's "old" debt into "new" debt. Although market trading by US persons in listed bonds previously issued by Venezuela and PdVSA is permitted under OFAC General License 3,<sup>4</sup> US persons are not permitted to purchase the listed bonds directly or indirectly from the government of Venezuela. Moreover, the Executive Order establishing these US sanctions includes the standard prohibition against "any transaction that evades or avoids, has the purpose of evading or avoiding, causes a violation of, or attempts to violate any of the prohibitions" expressed in the US sanctions relating to Venezuela.<sup>5</sup>

Beyond the refinancing and restructuring limitations noted above, US persons face separate constraints with respect to any dealings with Vice President Tareck Zaidan El Aissami, the head of the special committee appointed to oversee Venezuela's restructuring. The US placed Vice President El Aissami on OFAC's list of Specially Designated Nationals and Blocked Persons (SDN List) in February 2017.<sup>6</sup> OFAC's Frequently Asked Questions state that "OFAC sanctions generally prohibit transactions involving, directly or indirectly, a blocked person, absent authorization from OFAC, even if the blocked person is acting on behalf of a non-blocked entity," and as a result "U.S. persons should be careful when conducting business with non-blocked entities in which blocked individuals are involved."<sup>7</sup> The Vice President's status as an SDN thus adds another layer of risk for US persons with respect to any negotiations or transactions in which he plays a part.

Furthermore, stakeholders should consider US sanctions before planning for or undertaking amendments of existing Venezuela and PdVSA bonds. For example, an amendment transaction that includes extension of maturities could be considered issuance of "new" debt under US sanctions — even if the extension does not result in the exchange of existing bonds. Even if a sufficient majority of bondholders supports an amendment, the transaction could be complicated if the US and/or international financial institutions acting as trustees or fiscal agents for the relevant bonds are not prepared to participate in the transaction or to seek additional indemnities prior to doing so.

Finally, any US person that holds or obtains a judgment claim against an entity affiliated with the government of Venezuela may need to consider the impact of US sanctions before entering into a settlement of its claims.

## **What Next?**

With few viable options available for a restructuring, the timing of Venezuela's and PdVSA's recent payment and restructuring announcement may be part of a strategy to safeguard assets from enforcement action on the part of bondholders in the US and to minimize the impact of potential defaults on the government of Venezuela's and PdVSA's income from oil exports.

Whether or not individual creditors have premised their investment strategy on prosecution of enforcement action, they should expect that enforcement action will occur following payment defaults, whether prosecuted by bondholders or judgment creditors. The outcomes of these actions will impact recoveries for all creditors.

Those creditors that are prepared for potentially long-term litigation in the US and elsewhere will be best positioned to maximize their recoveries.

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## Endnotes

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- <sup>1</sup> Petróleos de Venezuela, S.A., Press Release (Nov. 2, 2017), [http://www.pdvsa.com/index.php?option=com\\_content&view=article&id=8487:pdvsa-begins-transfer-for-the-payment-of-principal-and-interest-on-2017-bond&catid=10:news&Itemid=908&lang=en](http://www.pdvsa.com/index.php?option=com_content&view=article&id=8487:pdvsa-begins-transfer-for-the-payment-of-principal-and-interest-on-2017-bond&catid=10:news&Itemid=908&lang=en).
- <sup>2</sup> Petróleos de Venezuela, S.A., Press Release (Nov. 3, 2017), [http://www.pdvsa.com/index.php?option=com\\_content&view=article&id=8493:communique-presidential-commission-to-renegotiate-the-foreign-debt-terms-of-the-republic-and-pdvsa&catid=10:news&Itemid=908&lang=en](http://www.pdvsa.com/index.php?option=com_content&view=article&id=8493:communique-presidential-commission-to-renegotiate-the-foreign-debt-terms-of-the-republic-and-pdvsa&catid=10:news&Itemid=908&lang=en).
- <sup>3</sup> <https://www.bloomberg.com/news/articles/2017-11-03/venezuelan-oil-too-big-to-fail-at-least-for-china-and-russia>.
- <sup>4</sup> OFAC General License 3 (Aug. 25, 2017), [https://www.treasury.gov/resource-center/sanctions/Programs/Documents/venezuela\\_gl3.pdf](https://www.treasury.gov/resource-center/sanctions/Programs/Documents/venezuela_gl3.pdf).
- <sup>5</sup> Executive Order 13808 (Aug. 24, 2017), <https://www.treasury.gov/resource-center/sanctions/Programs/Documents/13808.pdf>.
- <sup>6</sup> US Department of the Treasury, Press Release (Feb. 13, 2017), <https://www.treasury.gov/press-center/press-releases/Pages/as0005.aspx>.
- <sup>7</sup> US Department of the Treasury, OFAC FAQs: General Questions, [https://www.treasury.gov/resource-center/faqs/Sanctions/Pages/faq\\_general.aspx](https://www.treasury.gov/resource-center/faqs/Sanctions/Pages/faq_general.aspx).