2018 New York City Bankruptcy Conference

Venezuela: Obstacles and Opportunities

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CONCURRENT SESSION

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Crisis in Venezuela: Contributing Factors

Contributing Factors

- Oil prices
- Lack of economic diversification
- Subsidization of goods
- Hyperinflation
- Political unrest
- Sanctions

Oil Prices

- Venezuela has been an oil producer since 1914, and is currently a member of the Organization of Petroleum Exporting Countries ("OPEC").
- Hugo Chávez came to power in 1998 partly on the promise to use the country's oil wealth to help Venezuela's poor, funding infrastructure and housing projects.
- As oil prices fell from $111 per barrel in 2014 to a low of $27 per barrel in 2016, the Venezuelan government has curtailed its social programs, leading to an erosion of support among the population.

Lack of Economic Diversification

- According to OPEC, roughly 95% of Venezuela's export earnings come from oil.
- Historically, Venezuela has relied on oil for nearly all of its revenue, importing most other goods.
- As oil prices have fallen dramatically, the Venezuelan government has been left with less foreign currency to buy goods from abroad, contributing to shortages of critical goods. Venezuela's imports in 2017 were down 50% from 2016.

Subsidization of Goods

- As part of Chávez's promise to help Venezuela's poor, and current Venezuelan President Nicolás Maduro's efforts to continue his legacy, many essential goods, including food and medicinal products, were the subjects of very large government subsidies.
- As subsidies grew, it became increasingly profitable to smuggle subsidized goods out of the country for sale elsewhere. In addition, many manufacturers cut production due to limits on what they could charge for their goods. As a result, products like food and medicine have become scarce in Venezuela over the past few years.

Hyperinflation

- Venezuela's inflation rate has been above 50% since 2014, and reached 536.2% in 2017 due to the rapid depreciation of the local currency on the black market. The IMF estimates that inflation will reach 2,068.5% in 2018.
- Hyperinflation is due in part to currency controls first introduced by Chávez in 2003 to curb capital flight. Some businesses are authorized to buy dollars at preferential rates to purchase priority goods such as food or medicine.
- By selling U.S. dollars at different rates, the government contributed to a black market; businesses authorized to buy dollars at preferential rates could instead sell those dollars for a significant profit to third parties, rather than using them to purchase priority goods.
- On March 22, 2018, President Maduro ordered a re-denomination of the Venezuelan bolivar, dividing each denomination by 1,000 effective June 4, 2018. Economists are skeptical that the re-denomination will lead to improvements.

Political Unrest

- The political opposition has accused President Nicolás Maduro of moving towards a dictatorship and inappropriately consolidating his power.
- In January 2016, the Supreme Court suspended the election of four legislators for alleged voting irregularities, three of whom were from the opposition party – the opposition party accused the court of trying to strip the opposition of their supermajority in the legislature.
- The National Assembly, controlled by the opposition party, refused to approve the country's state-run oil company (PDVSA) entering into joint ventures with private companies. In response, the Supreme Court took over the legislative powers of the National Assembly, but reversed its decision the following day after protests broke out.
- In July 2017, elections were held for a Constituent Assembly, comprised entirely of government supporters. The Constituent Assembly will have the power to rewrite the constitution, and is seen as an attempt to strip power from the opposition-controlled National Assembly.
- Presidential elections have been postponed several times. Most recently, in March 2018, the presidential vote was postponed from April 22, 2018 to May 20, 2018. Several opposition parties have been banned from participating in the presidential elections.

Sanctions

- The United States imposed sanctions on Vice President Tareck El Aissami and eight members of the Supreme Court in early 2017, and in July 2017 added more than a dozen current and former Venezuelan officials to the list of sanctioned individuals.
- In August 2017, after the Constituent Assembly election, the United States imposed sanctions against President Maduro, only the fourth foreign leader to receive such a penalty.
- Also in August 2017, the United States imposed sanctions effectively blocking U.S. financial institutions from investing in new Venezuelan or PDVSA bonds. These measures, in combination with President Maduro's refusal to seek help from the IMF, led the Venezuelan government to announce in November 2017 that it would restructure all foreign debt. Venezuela officially defaulted on $200 million in debt interest payments later that month.

Sanctions

- Currently, there are three types of sanctions that are being imposed on Venezuela:
  - There are targeted financial sanctions (asset freezes) against certain Venezuelan government officials, pursuant to Executive Order 13692 of 9 March 2015, issued under IEEPA (50 USC 1701 et seq);
  - There are specific drug-trafficking-related sanctions against Tareck El Aissami, Venezuelan Vice President, pursuant to the Kingpin Act (21 USC 1901 et seq.); and
  - There are financial markets restrictions imposed pursuant to Executive Order 13808 of 24 August 2017 (issued under IEEPA).
    - EO 13808 prohibits engaging in certain transactions related to, providing financing for, or otherwise dealing in debt or equity of the Venezuelan government or state-owned entities, issued on or after the sanctions effective date of 25 August 2017 (“new debt” or “new equity,” respectively), as well as transactions in certain preexisting bonds.

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Sanctions

- As to August 2017, EO 13808 sanctions had four basic components:
  - A ban on dividend payments or any other distribution of profits to the Government of Venezuela by any entity owned or controlled, directly or indirectly, by the Government of Venezuela;
  - A ban on all transactions involving new equity (i.e. all financing in support of, and any dealing in, including provision of services in support of, such new equity) issued by, on behalf of, or for the benefit of the Government of Venezuela;
  - A ban on all transactions involving new debt (i.e. related to, providing financing for, or otherwise dealing in debt instruments) with a maturity of longer than 90 days (for PDVSA debt) or longer than 30 days (for all other Venezuela sovereign debt); and
  - A ban on transactions involving bonds issued by the Government of Venezuela prior to the order’s effective date (i.e. old bonds), unless they fall within the scope of General License 3.
- General License 3 authorizes “all transactions” otherwise prohibited by EO 13808 with respect to certain existing bonds listed in the General License. It focuses on bonds issued to / intended for the international market, and includes multiple PDVSA bond issuances, with maturity dates between 2 Nov 2017 and 12 April 2037.
  - It does not authorize exchanging the bonds for new Venezuelan sovereign debt or equity.
  - If a restructuring results in the issuance of “new debt” by Venezuela, a specific license would be required unless OFAC issues a new General License covering the new bond issuance.

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Sanctions

- In February 2018, Venezuela officially launched its new digital currency, called the "petro". The petro is nominally backed by Venezuela's reserves of oil, gas, gold and diamonds, and is meant to help overcome US and EU sanctions. However, President Trump signed an executive order barring any US-based financial transactions involving the petro.
- China has lent Venezuela more than $60 billion since 2001, and is the country's largest creditor. In November 2017, China's Foreign Ministry stated that the Venezuelan government has "the ability to properly handle their debt issue."
- Venezuela also has growing ties to Russia. As of August 2017, Russian state oil company Rosneft was reselling approximately 225,000 barrels of PDVSA oil per day, 13% of Venezuela's total exports, and Russia has increasingly shown willingness to lend to Venezuela.

PDVSA Bonds - Background Chronology

April 2007:	PDVSA issues PDVSA BOND 2017; PDVSA BOND 2027; and PDVSA BOND 2037. The PDVSA BOND 2017 maturity date was 12 April 2017.
October 2010:	PDVSA issues PDVSA BOND 2017. This bond maturity date was 2 November 2017.
February 2011:	PDVSA issues PDVSA BOND 2022. This bond maturity date is 17 February 2022.
June–July 2016:	News agencies start reporting PDVSA is likely to default.
October 2016:	PDVSA issued a request for a debt swap exchanging bonds maturing in April and November 2017 for new bonds maturing in 2020. PDVSA 2020 bonds are backed by collateral in the form of a 50.1% lien on shares in CITGO Holding.

PDVSA Bonds - Background Chronology

24 August 2017: U.S. Executive Order issued imposing additional sanctions on Venezuela, specifically focused on financial markets. The order bars U.S. nationals and entities from engaging in a number of transactions involving existing bonds, as well as those involving debt or equity issued after 25 August 2017.

Mid-to-late October 2017: News reports note PDVSA will likely be unable to comply with its bonds payment obligations; some consider default near certainty.

13 October 2017: Payment due of PDVSA 2027 bonds; 30-day grace period for payment.

27 October 2017: Payment due of PDVSA 2020 bonds.

2 November 2017: Payment due of PDVSA 2017 bonds: US$1.169 billion, including US$1.121 billion in principal and US$47 million in interest.

Early November 2017: PDVSA 2027 bonds gain ahead of planned 13 November meeting between Government and creditors

PDVSA Bonds - Background Chronology

13 November 2017: Venezuela officials gather with sovereign and PDVSA creditors. The meeting lasted only 30 minutes; Vice President Tareck El Aissami was the only official to speak, and devoted most of his prepared remarks to comments against Donald Trump and global financiers who he said have conspired to keep the country from making debt payments on time.

On same day, European Union's foreign affairs council approved targeted sanctions to impose an arms embargo, a freeze on assets, and travel restrictions on Venezuela.

14 November 2017: Venezuela & PDVSA fail to make combined US$281m in coupon payments as grace periods end; S&P downgrades Venezuela to selective default.

16 November 2017: International Swaps and Derivatives Association (ISDA) Americas Determinations Committee resolves that "failure to pay credit event had occurred" with respect to both PDVSA bonds and other sovereign bonds (Venezuela's 7.75% bonds maturing in 2019).

PDVSA Bonds - Background Chronology

14 December 2017:	PDVSA announces payment of US$539 million in interest on four separate bond tranches maturing in 2024, 2026, 2021 and 2035.
January 2018:	EMTA recommends that Venezuelan sovereign bonds be traded "flat" (without accrued interest), consistent with how bonds in default are typically traded.
February 2018:	EMTA recommends that PDVSA bonds be traded "flat". Venezuela and PDVSA are, combined, behind on more than $1.5 billion in payments. PDVSA makes delayed interest payment on PDVSA 2022 bonds.
14 April 2018:	Summit of the Americas begins in Lima, Peru.
20 May 2018:	Early presidential elections have been re-scheduled to this date.

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Question Presented

- Is a transfer by a non-debtor transferor, to the debtor, actionable under the Delaware Uniform Fraudulent Transfer Act ("DUFTA")?

Facts[1]

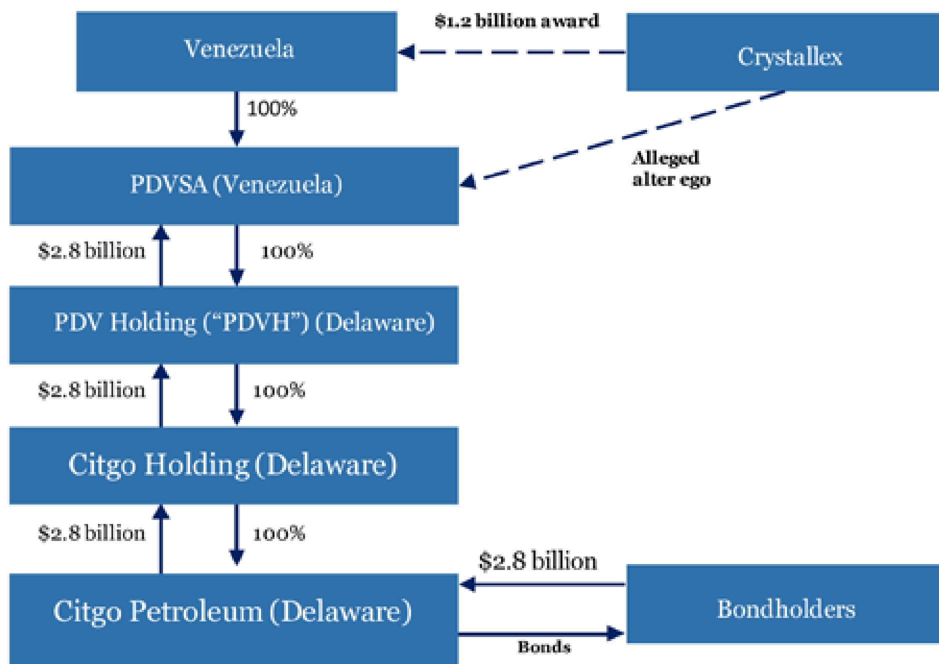
- Crystallex International Corp. ("Crystallex"), a Canadian company, owned Las Cristinas, a Venezuelan gold mine.
- Las Cristinas had one of the largest unmined gold reserves in the world (between 17 and 26 million ounces).
- Crystallex invested over $640 million in Las Cristinas.
- Venezuela nationalized Las Cristinas in 2011 and transferred it to Petróleos de Venezuela, S.A. ("PDVSA"), which then sold 40% of Las Cristinas to the Venezuelan Central Bank for $9.5 billion.

[1] From Crystallex Int'l Corp. v. Petróleos de Venezuela, S.A., 879 F.3d 79 (3d Cir. 2018).

Facts *(cont'd)*

- Crystallex brought World Bank arbitration proceeding against Republic of Venezuela, for violating Canadian-Venezuelan bilateral investment treaty.
- Arbitrators awarded $1.2 billion to Crystallex.
- United States District Court for District of Columbia confirmed arbitration award.
- Result: Crystallex is a judgment creditor of Republic of Venezuela. Crystallex alleges that PDVSA is an alter ego of Republic.
- But: according to Crystallex, "on numerous occasions, Venezuelan government officials stated publicly that Venezuela would refuse to pay any anticipated arbitral award against it and would proactively thwart efforts to enforce such awards."

Facts *(cont'd)*



District Court

- Crystallex sued PDVH in United States District Court for District of Delaware.
- Alleged PDVH violated Section 1304 of DUFTA:

  "A transfer made … by a debtor is fraudulent as to a creditor … if the debtor made the transfer … [w]ith actual intent to hinder, delay or defraud any creditor." (emphasis added)

- District Court denied PDVH motion to dismiss:
  - Held that PDVH's transfer of $2.8 billion to PDVSA was "**by a debtor**."
  - Merriam-Webster definition: The word "by" includes "through the agency or instrumentality of" and "on behalf of."
  - "Given the alleged 'extensive, if not dominating, involvement' of the debtor Venezuela, the PDVH transfer was executed by an 'instrumentality' of the debtor or on its 'behalf.'"
  - Thus, a non-debtor transferor can be liable to a creditor (or alleged creditor) of the transferee.

Third Circuit

- Reversed District Court.
- Given diversity jurisdiction, Court had to predict how Delaware Supreme Court would resolve the issue.
- No Delaware Supreme Court decision on whether a non- debtor transferor can be liable.
- Third Circuit looked primarily to two Delaware Chancery Court decisions:
  - *Edgewater*
  - *Wickes Trust*
- Also looked to Chancery Court decisions applying federal bankruptcy law on fraudulent conveyances.
- Emphasized that under Delaware law, parent and subsidiary are separate legal entities
  - Crystallex did not allege that PDVH is alter ego of Venezuela or PDVSA
  - No other allegations sufficient for veil-piercing
- Rejected Webster's definition as inapplicable.
- Vigorous dissent.
- Denied Crystallex's motion for rehearing.

Past as Prologue: Recent Sovereign Debt Restructurings

Past as Prologue

CONSIDERATIONS FOR SOVEREIGN DEBT RESTRUCTURING

- Will domestic creditors and foreign creditors be treated the same?
- Is there an effective binding mechanism to prevent holdouts?
- What leverage will holdouts have to precipitate further defaults?
- Have economic conditions improved such that the country can make payments on its restructured debt?

Argentina
REASONS FOR DISTRESS

- In the 1980s, Argentina's debt grew from $8 billion to $43 billion under a military dictatorship. The post-dictatorship government employed the Austral Plan:
  - Commencing in 1985, Argentina sought to stabilize the economy and reduce high inflation by combining tight fiscal policy and monetary restraint with price and wage controls.
  - The plan introduced a new currency, the Austral, devalued the currency and froze the exchange rate and created a conversion table for existing contracts known as the desagio.
  - Under the plan, inflation decreased by 26.9% in two months.
  - The improvement lasted one year, when inflation rose once again.
- In 1991, Argentina attempted to peg its currency to the U.S. dollar. The strategy still proved ineffective, and Argentina accepted $11 billion in loans in 1995. Under the terms of the loans, Argentina agreed to reform its social security system, increase the minimum age of retirement, and implement other austerity measures.
  - The negative impact of the austerity measures led to violent revolts. The country also faced mass emigration and rapid changes to leadership (at one point, there were five presidents over ten days). The IMF loaned $40 billion to Argentina in 2000.
  - Argentina ultimately defaulted on $102 billion of debt and declared a moratorium on principal and interest payments.

Argentina
RESTRUCTURING

- The Argentine government originally set out to restructure its debt in two phases.
  - In the first phase, Argentina would exchange debt held by Argentine residents and guarantee the necessary funds to honor new debt.
  - In the second phase, the government planned to restructure debt held by nonresidents but omit the guarantee on resources needed to fund the debt. The government did not make it to Phase II.
- As part of this plan, Argentina exchanged $51 billion in debt.
  - One month after this exchange, facing political upheaval, the government defaulted.
  - Soon after, the government "pesoized" guaranteed loans.
  - Domestic creditors tried to claim back the original bonds.

Argentina

RESTRUCTURING

- In 2005, following meetings with the IMF and World Bank, Argentina made a final offer to bondholders, allowing them to choose among the following options:
  - exchange at par for new bonds with 3.2% interest and a 35-year maturity,
  - exchange at a 66% discount for bonds with 8.28% interest and a 30-year maturity, or
  - exchange for bonds for consumer-price-indexed Argentine peso bonds, likely having 3.31% interest and a 42-year maturity.
- The government targeted potential holdouts to the exchange by mandating that future improvements to the conditions of the exchange be extended to all exchange participants as well as passing a law that made it more difficult to reopen the exchange or settle with holdouts.
- 76% of debt was exchanged, at an estimated 71 to 75% haircut. The government issued $35.3 billion in new debt. Subsequently, the ratio of federal debt to GDP decreased by 76% to 72%, compared to 2002.
- Without a binding mechanism to drag nonexchanging creditors, though, there were holdouts, and certain of those holdouts intensely litigated with Argentina.

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Argentina

RESTRUCTURING

- Certain holdout creditors pursued full payment in New York courts.
  - The litigation precipitated another default in 2014 when the court ordered that Argentina could not pay the bondholders who agreed to the exchange until the government settled with the holdout creditors.
  - The holdout creditors agreed to a $4.65 billion settlement following an intense mediation.
- Argentina had accused the United States of violating Argentina's sovereignty and immunities and appealed to the UN General Embassy for relief. The UN adopted a sovereign debt restructuring proposal, a set of principles to resolve disputes between distressed countries and their creditors, in 2014. The United States voted against the proposal.

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Ecuador

REASONS FOR DISTRESS

- In 1998, Ecuador's banking system collapsed and a currency and public finance crises ensued following a reversal of capital inflows, domestic issues, the Russian and Brazilian financial crises, low oil prices, and El Niño.
- Ecuador was the first country in history to default on its "Brady bonds" (i.e., U.S.-dollar denominated bonds issued by developing nations), in 1999. In 2000, after failing to restructure specific debt instruments, the government launched a bond exchange.
- Ultimately, this did little to avoid Ecuador's 2000 currency crisis or banking crisis, which resulted in the government declaring a one-week bank holiday and a one-year deposit freeze.

Ecuador

RESTRUCTURING

- In 2000, Ecuador made an exchange offer for defaulted Brady and Eurobonds for a single dollar-denominated Eurobond maturing in 2030 for a new instrument with an interest rate of 4%, increasing each year up to 10%.
  - Bondholders could choose between converting the 30-year bond to a 12-year bond with a 12% coupon for further debt reduction.
  - Ecuador committed to retire some of the face value of the new bonds every year by purchasing the debt in the secondary market or through debt-for-debt exchanges.
  - Ecuador further agreed to issue additional bonds maturing in 2030 for holders of the restructured debt in the event of a new default in the ten years following the exchange.
  - Ecuador introduced exit consents in which bondholders automatically consenting to change nonpayment terms of the old instruments, making the old instruments less appealing.
- 97% participated in the exchange by August 2000. Holdout creditors were paid in full. The government issued two other sets of bonds, and rescheduled domestic bonds maturing from September 1999 to the end of 2000.

Greece

REASONS FOR DISTRESS

- In the 1980s, Greece's debt rose from 25% to 100% of its GDP.
- Greece's low economic growth and high inflation continued, though the country was able to join the European Monetary Union in 2001.
- However, despite the access to cheaper debt, or perhaps because of that access, Greece borrowed $145 billion in 2010.
- As Greece's debt load increased and the possibility for full repayment decreased, Greece agreed to enforce austerity measures.

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Greece

REASONS FOR DISTRESS

- Austerity measures and additional capital were insufficient to solve Greece's debt crisis. So, Greece enacted a debt exchange program:
  - New Greek bonds maturing in 2042 were issued and included a step-up coupon from 2% to 4.3%.
  - Bondholders also received new EFSF notes with a face value of 15% of the face value of the tendered bonds.
  - Bondholders also received GDP warrants, composed of annual payments of 1% of their notional amounts if Greece met a defined GDP threshold.
  - Roughly €177 billion of the €205 billion bonds were governed by Greek law.
  - The new Greek government bonds had a 46.5% nominal value. The exchange reduced the nominal amount of Greek debt by €106 billion.
- The day before the issuance, Greece passed a law authorizing the government to insert collective action clauses in existing Greek law bonds.
  - The collective action clauses deemed all bondholders to accept the bond terms should 66% of holders accept the exchange.

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Chapter 15 Overview

Chapter 15

HISTORY AND PURPOSE

- Congress enacted Chapter 15 of the Bankruptcy Code in 2005. It adopts the UN Commission on International Trade Law's (UNCITRAL) Model Law on Cross-Border Insolvency.
- Congress enacted Chapter 15 of the Bankruptcy Code in order to:
  - Promote cooperation in cross-border insolvency cases among U.S. courts and foreign jurisdictions;
  - Establish greater legal certainty for trade and investment in the U.S.;
  - Provide for the fair and efficient administration of cross-border insolvencies, protecting the interests of creditors, the debtor, and other interested entities;
  - Protect and maximize a debtor's assets; and
  - Facilitate the rescue of financially troubled businesses to protect investment and preserve employment.

Chapter 15

COMMENCING A CASE

- To commence a proceeding under Chapter 15 in the United States, a "foreign representative" of the debtor files a petition with the bankruptcy court for "recognition" of a "foreign proceeding."
  - "Foreign representative" means a person or body, including a person or body appointed on an interim basis, authorized in a foreign proceeding to administer the reorganization or the liquidation of the debtor's assets or affairs or to act as a representative of such foreign proceeding. 11 U.S.C. § 101(24).
  - "Foreign Proceeding" means collective judicial or administrative proceeding in a foreign country, including an interim proceeding, under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation. 11 U.S.C. § 101(23).
- In *In re ABC Learning Centres Ltd.*, 728 F.3d 301 (3d Cir. 2013), the court held that a proceeding could constitute a "foreign proceeding" where it meets the requirements imposed by Chapter 15 and the rules and procedures governing such proceeding promote similar goals to those of the U.S. Bankruptcy Code and do not offend U.S. public policy.

Chapter 15

RECOGNITION AND RELIEF

- Upon a party's filing of a petition for recognition, the court may grant provisional relief, including a stay on execution against the debtor's assets. 11 U.S.C. § 1519.
- Following the petition, and after notice and a hearing, the U.S. court may authorize an order recognizing the foreign proceeding either as a "foreign main proceeding" or a "foreign non-main proceeding." 11 U.S.C. § 1517.
  - A foreign main proceeding is one pending in the country where the debtor has the center of its main interests ("COMI"). 11 U.S.C. § 1517.
    - Absent evidence to the contrary, a debtor's registered office is presumed to be its COMI.
    - Remedies following recognition of a foreign main proceeding include a mandatory automatic stay for a foreign debtor's assets in the U.S. 11 U.S.C. § 1520.
  - A foreign non-main proceeding is one pending where a debtor "has an establishment," but is not its center of main interests. 11 U.S.C. § 1517.
    - Upon recognition of a foreign non-main proceeding, the court has discretion to grant remedies.

Chapter 15

RECOGNITION AND RELIEF

Upon recognition, the foreign representative may obtain further relief from the bankruptcy court, state courts, or federal courts, file a full bankruptcy case, act as a party of interest in a pending U.S. bankruptcy case and intervene for the debtor in other U.S. cases. 11 U.S.C. §§ 1509, 1511; 1512, 1524.

- If a company's assets in the United States are sufficiently complex to merit a domestic bankruptcy case, a debtor or creditor may commence a full Chapter 7 or Chapter 11 bankruptcy case. 11 U.S.C. § 1520(c).
- A bankruptcy court may abstain from acting pursuant to Chapter 15 if the court's action would run "manifestly contrary" to U.S. public policy. 11 U.S.C. § 1506.
  - This exemption must be narrowly construed and be invoked only when circumstances are exceptional and concern fundamental, important issues for the United States. *Lavie v. Ran*, 607 F.3d 1017 (5th Cir. 2010).

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Chapter 15

A TOOL FOR SOVEREIGN DEBT RESTRUCTURING?

The Bankruptcy Code is silent about whether a foreign country could be a chapter 15 debtor

- Section 1501 explains who may be a debtor under chapter 15: "an entity subject to a foreign proceeding"
  - The practical limiter, then, on a foreign country being in chapter 15 is whether the country itself could be subject to a foreign insolvency proceeding
- Entities prohibited from filing a bankruptcy case under chapter 7 are also prohibited from filing for chapter 15. 11 U.S.C. §§ 109(b), 1501(c). These include foreign banks with branches in the United States. However, foreign sovereigns are not excluded.
- If a country were to file for chapter 15, it would undoubtedly raise policy issues, including whether it fits the purpose of chapter 15
- Chapter 15 may, though, be a practical tool for restructuring the debt of quasi-governmental entities that can be subject to a foreign proceeding

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