Venezuela’s Restructuring: A Path Forward

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I. INTRODUCTION

As we witness what we (and many in the international community)[2] hope are the final throes of the Maduro regime, Interim President Guaidó and the National Assembly have begun the process of preparing Venezuela for the transition from a failed state to a functioning state, where a broken economy, corruption and despair are replaced by recovery, reconstruction and hope. A broad swath of Venezuelan economists and other experts have reached consensus on a plan to restore civil society and rebuild the economy (the so-called Plan País), starting with steps to be taken immediately following the departure of the Maduro government. The Guaidó administration, in coordination with the National Assembly, is also preparing a series of draft laws that will begin the process of restoring democracy, restarting the economy and reestablishing the independence and credibility of the institutional pillars of Venezuelan life. Among the most urgent tasks facing a new Venezuelan government will be, of course, measures to address the humanitarian crisis—the provision of food and medicine and an end to lawlessness—and securing the needed funding for these efforts without delay.

A second order of concern, but one that must be addressed early on if only to ensure that its neglect does not derail or delay measures to address Venezuela’s most urgent needs, is the treatment of Venezuela’s more than $175 billion of external financial obligations, virtually all of which are in default. Ideally, a framework to deal with these obligations will include the following objectives:

i. inclusion of all significant classes of claims against the public sector such as bonds and other debt of Petróleos de Venezuela, S.A. (“PDVSA”), the Republic of Venezuela (the “Republic”) and Electricidad de Caracas (“Elecar”), bilateral and multilateral credits (including China and Russia), arbitration (expropriation) claims and trade creditors (goods and services);

ii. establishment of a process for Venezuela and its creditors to reach decisions by negotiation and consensus;

iii. elimination, where possible (or de-risking where it is not), of the threat posed by holdout creditors;

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[2] More than 60 countries have recognized the new Guaidó government as of March 2019.

iv. recapitalization of PDVSA so that it will be able fund itself in the market on reasonable terms;

v. inclusion of tools to address burdensome or illegitimate contractual undertakings entered into by the Maduro regime and the recovery of billions of dollars that have been stolen from the State through fraudulent and criminal acts; and

vi. reorganization of the public finances of Venezuela such that its external debt (including any newly issued contingent obligations) is sustainable and not only reflects the country's capacity to pay but also is sized and shaped to encourage direct investment and renewed market access.

Building on the framework that the authors developed in 2017,[3] we set out below a refined and expanded path forward that seeks to satisfy these objectives by setting forth a roadmap for a realistic and comprehensive debt restructuring process.[4] To be clear, this framework is intended to be neutral between Venezuela and its creditors and not to enhance or diminish either side's bargaining power. We have no doubt that the negotiation of the nature and extent of the relief granted to Venezuela by its creditors and the treatment of different classes of creditors will prove highly contentious. What is not in dispute are the complexity and challenges of the exercise. The efforts of all stakeholders will be significantly advanced, and unnecessary and fractious disputes avoided, if at the outset there is agreement on a common restructuring framework built on principles of collective action and consensus. It is in this spirit that we put forward our proposal.

II. PDVSA – LOOKING BEYOND THE TRADITIONAL SOVEREIGN TOOL KIT

Venezuela's public external debt is comprised primarily of obligations of the Republic and PDVSA, the state-owned oil company. Some $62 billion is in the form of unsecured bonds issued by the Republic and PDVSA, and the balance includes substantial bilateral and multilateral debt, claims of vendors and contractual counterparties and claims resulting from litigation and arbitration.[5] The most critical and time-sensitive task is to normalize the status of PDVSA and protect its assets and operations, notwithstanding the fact that total claims against the Republic exceed those against PDVSA. Venezuela's future recovery and its ability to generate hard currency are and will remain for a long time heavily dependent on the country's ability to exploit its abundant oil and gas reserves. And although the role of PDVSA going forward may change dramatically as substantial private capital is committed to the oil and gas industry and Venezuela relies more on royalties and income taxes than on proceeds from exports by PDVSA itself, PDVSA is nonetheless likely to continue to play an important role in this critical sector of the economy. Thus, safeguarding the assets of PDVSA outside Venezuela—both tangible assets like Citgo as well as accounts receivable—and its ability to conduct business

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[3] Mark A. Walker and Richard J. Cooper, *Venezuela's Restructuring; A Realistic Framework* (September 19, 2017).

[4] We have assumed for purposes of this article that the bonds issued by the Republic and PDVSA will be restructured on similar economic terms. The framework proposed would work equally well should the stakeholders reach agreement on different terms.

[5] See "Annex A: Summary of Venezuela's External Liabilities".

around the world are of paramount importance and will be essential to its ability to attract new capital and strategic partners.[6] Similarly, PDVSA's balance sheet must be restructured so that it is once again viewed as an independent, creditworthy enterprise on a stand-alone basis that can finance its operations in the ordinary course without the assistance of the sovereign.

Fortuitously, at its core, PDVSA is essentially a commercial enterprise, which allows an approach to a resolution of its financial problems that offers significant advantages over the traditional techniques used to arrive at an agreed restructuring of sovereign debt. Although the ultimate restructuring terms agreed to with respect to debt of the Republic and PDVSA may be comparable, and although we believe that the restructuring of the Republic's debt should be pursued in tandem with the restructuring of PDVSA's debt, the approach we propose embraces their differences and offers a path forward that will create significant value to all stakeholders. Thus, we would employ different restructuring techniques in each case to achieve common goals. And equally importantly, we believe that the approach we suggest for restructuring PDVSA's debt can be tailored to create powerful incentives for creditors of the Republic to join in a restructuring at the same time.

To date, the debate over how to restructure PDVSA's debt has focused on two very different techniques: the use of a local, Venezuelan and Chapter 9-like reorganization statute supported by a U.S. Chapter 15 ancillary proceeding (the "Local Reorganization Law Solution") or the issuance of an Executive Order by the U.S. Government (the "Executive Order Solution")[7] followed by a traditional sovereign bond exchange and consent solicitation. Although both approaches share a common feature—a stay of creditor remedies—they differ in most, if not all other respects.[8]

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[6] Although some commentators have proposed that a new Venezuelan government create a new PDVSA which would be granted the exclusive right to exploit the country's hydrocarbon resources in the future and would have no liability for the obligations of existing PDVSA (or undertake transactions such as sales or liens on assets that would have similar effect), the authors do not consider this a credible solution. (At best, it would lead to protracted litigation, subject the new government to charges of acting in bad faith and disrupt efforts to arrive at a fair and consensual restructuring.)

[7] Buchheit and Gulati in fact propose three variants of an Executive Order: the first or base case would deny access to U.S. courts to creditors making claims against the Republic, PDVSA or their U.S. assets and is the Executive Order to which we refer throughout this article. Other, more far reaching (indeed extreme) variants would either couple this denial of access with a collective action mechanism imposed by the same Executive Order and applicable only to U.S. creditors in an unspecified way or go even farther and dictate the terms of a restructuring binding on U.S. (but not foreign creditors). Lee C. Buchheit and G. Mitu Gulati, *Sovereign Debt Restructuring and U.S. Executive Power* (Oct. 29, 2018) (hereafter, "Buchheit & Gulati"). For additional analysis of these proposals, see Mark A. Walker, *Restructuring Venezuela's Debt: An Update* (Dec. 11, 2018).

[8] As a threshold matter, whereas the Local Reorganization Law Solution is capable of being implemented by Venezuela without U.S. Government support (though it would clearly benefit from such support including the filing of a possible amicus brief in support of PDVSA's Chapter 15 process), the United States would first have to embrace the Executive Order Solution. The Executive Order Solution would require the United States to take positions on debt restructuring issues contrary to its historical positions; assume the risk of liability from closing off court access, impairing the contractual rights of creditors and/or taking the property interests of creditors; and pick winners and losers between and among Republic and PDVSA creditors. That the United States would (or should) do so is not a given, notwithstanding the support of the Executive branch and Congress for the Guaidó administration and the imposition of sanctions that serve in part to preserve Venezuelan assets in the United States.

Fundamentally, the Local Reorganization Law Solution recognizes that PDVSA is a commercial enterprise—although owned by the state—dependent each and every day on transacting business with counterparties across the globe. The Local Reorganization Law Solution would provide a framework to achieve a consensual restructuring of all claims against PDVSA and would include not just a temporary stay on creditor actions but also the necessary tools to advance PDVSA's reorganization and recapitalization while enabling it to emerge from the process with a full and complete discharge of its debts. The process would provide the customary guard rails associated with the restructuring of state-owned municipal enterprises, but would leave PDVSA well positioned to attract new investment. It would also reinforce the separateness of PDVSA as an independent state-owned public enterprise, which will support future market access as well as the defense of claims by Republic creditors that PDVSA is the alter ego of the Republic.

The Executive Order Solution provides a means to immunize PDVSA's assets from the risk of creditor litigation and enforcement efforts in the U.S.,[9] but lacks essential elements to achieve a permanent or even stable solution. Under the Executive Order Solution, claims of holdouts would not be discharged, and therefore their ability to litigate and pursue assets of PDVSA outside the U.S. (and within the U.S. after the Executive Order ceases to remain in effect) would remain unimpaired, permitting them to prevent or disrupt PDVSA's ability to operate in global markets. In addition, the Executive Order Solution provides no process to reconcile claims, to deal with creditors by class or for a supermajority of creditors (collective action) to have the right or ability to bargain effectively with the debtor, which is at the heart of a consensual solution. In essence, the Executive Order Solution, imposing a stay of undetermined or arbitrary duration, is designed to tilt the negotiating scale so decidedly in favor of PDVSA that creditors would have no choice but to accept whatever offer PDVSA makes. On the other hand, the claims of PDVSA's holdout creditors, and we suspect there would be many, would continue to accrue interest at contractual rates prior to any judgment being entered, and could easily jeopardize PDVSA's access to new investment and new financing. The Executive Order Solution would also ensure that PDVSA remains mired in litigation for decades to come—both from holdouts as well as those challenging the validity of the Executive Order.[10] Finally, an Executive

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[9] A broader protective mandate could be obtained if the United Nations Security Council were to adopt a resolution to that effect, as it did in the case of Iraq, but we are skeptical that such a resolution would receive the support of all veto-wielding members.

[10] U.S. courts have largely rejected creditors' claims based on the exercise of Presidential authority to freeze foreign assets under U.S. jurisdiction, *e.g., 767 Third Avenue Associates v United States*, 48 F.3d 1575 (Fed. Cir. 1995) (rejecting takings claim by landlord of Yugoslav Consulate in NY seeking reimbursement for leases breached by Yugoslavia after OFAC closed the Consulate and froze Yugoslav assets); *Chang v. United States*, 859 F. 2d 893 (Fed. Cir. 1988) (rejecting takings claim of U.S. persons who were forced to abandon their employment contracts in Libya in order to comply with the U.S. sanctions against Libya); *Paradissiotis v. United States*, 304 F. 3d 1271 (Fed. Cir. 2002) (rejecting the takings claim of a Libyan national who was prevented from exercising stock options on frozen Libyan assets, which expired while sanctions were in place). The Executive Order Solution, however, goes considerably further than freezing assets for some limited time and purports to deprive U.S. and non-U.S. creditors not only of access to U.S. courts but also of any ability to adjudicate their claims. Some variants of the proposal go even further and purport to limit amounts otherwise due under New York-law governed contracts to amounts "[]consistent with the restructuring terms accepted by the supermajority of creditors". Buchheit & Gulati at 18. We believe that a deprivation of the rights of holdout creditors to enforce their contracts in court or to bind them in some fashion to the recovery agreed to by a supermajority would expose the Executive Order Solution to even greater legal vulnerability. In addition, such an Executive Order would be contrary to the U.S. Government's longstanding

Order that not only precludes recovery of a judgment against U.S. assets but also (unlike the Local Reorganization Law Solution) precludes judicial determination of what in fact is owed to its creditors would leave PDVSA with uncertainty as to its outstanding obligations, a fact that will negatively affect its ability to transact business or seek investment from its counterparties.

III. THE LOCAL REORGANIZATION LAW SOLUTION FOR PDVSA

Because PDVSA is not a sovereign state but an instrumentality of a sovereign, the architects of PDVSA's restructuring need not confine themselves to the traditional tools employed by sovereigns to restructure their debts.[11] As we have previously written, as an instrumentality, if Venezuela were to adopt a local reorganization law for PDVSA and other instrumentalities of the State modeled on Chapter 9 of the U.S. Bankruptcy Code, this law could be used to protect PDVSA's assets in Venezuela and, if supported by a U.S. Chapter 15 proceeding[12] and similar proceedings in other jurisdictions, its assets in the U.S. and elsewhere pending the resolution of a restructuring.[13]

Even before the new Guaidó Government assumes power in Venezuela, the National Assembly should begin the process of drafting and enacting a new public corporation reorganization law modeled on Chapter 9. This law would allow PDVSA (and potentially other public sector entities) to address their debt and operational challenges in a collective, centralized proceeding that offers not only protection from its creditors but also an opportunity to obtain a full discharge of its debts. Additionally, this law would facilitate new investment and provide protections for those vendors, counterparties and other stakeholders that continue to do business with PDVSA while it sorts through its financial and operational issues, which could take considerable time. Ideally, a draft of this law would be published prior to enactment and stakeholders would be given an opportunity to comment on the law. We refer to this law as the "Venezuelan Public Sector Revitalization Law".

The Venezuelan Public Sector Revitalization Law should be constructed to provide PDVSA and other public sector entities[14] the ability to restructure their debts fairly and

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policy taken first in 1984 in *Allied Bank Int'l v. Banco Credito Agricola del Cartago* of opposing a sovereign debtor's attempt to unilaterally alter through litigation in the United States the terms of a debt instrument that is valid under New York law.

[11] PDVSA's disclosure documentation includes a risk factor stating that the ability of holders to recover their investment may be adversely affected if PDVSA is subjected to a Venezuelan bankruptcy or insolvency law.

[12] PDV Insurance Company Ltd., a Bermudian entity and PDVSA wholly owned subsidiary, obtained recognition of its Bermudian liquidation proceeding under Chapter 15 of the Bankruptcy Code. *See* Order Recognizing Bermuda Proceeding of PDV Insurance Company Ltd. As a Foreign Main Proceeding and Granting Related Relief, *In re PDV Ins. Co., Ltd.*, Case No. 18-12216 (MEW) (Bankr. S.D.N.Y. Aug. 20, 2018) (ECF. No. 11). Note, however, that this was obtained on an uncontested basis and does not raise the same issues that could potentially be relevant to recognition of a Venezuelan proceeding for PDVSA.

[13] We believe that PDVSA would be recognized as a Chapter 15 debtor and the Venezuelan proceeding as a "foreign proceeding" under Chapter 15. Chapter 11 relief, however, is unavailable to the Republic and could only be available to PDVSA if it could prove that it is not an instrumentality of Venezuela. For more information on the arguments that support Chapter 15 recognition, see Mark Walker and Richard Cooper, *Venezuela's Restructuring: A Realistic Framework* (Sep. 19, 2017).

[14] Although PDVSA is by far the most important Venezuelan entity that will need to address its liabilities, other Venezuelan public sector entities, such as Elecar, may also find it beneficial to take advantage of this new law,

effectively and to minimize the risk that a U.S. Bankruptcy Court would refuse to recognize and enforce the law and any resulting restructuring plan.[15] To accomplish these goals, the Venezuelan Public Sector Revitalization Law should:

i. provide for a stay of creditor remedies;

ii. include a robust process to identify, reconcile and validate creditor claims and to classify creditor claims in a rational manner (potentially allowing separate treatment for claims of bondholders, vendors, bilateral creditors and counterparties whose executory contracts have been rejected by PDVSA because it declined to assume the obligations thereunder);

iii. provide the Venezuelan court with the authority to adjudicate disputed claims and resolve issues such as the treatment of original issue discount, claims of invalidity due to the absence of required legislative or other approvals, fraud or equitable defenses;

iv. permit the debtor to reject executory contracts such as long-term contracts for the sale of oil that have been entered into by the Maduro regime on terms unfavorable to PDVSA;

v. provide certainty to vendors and suppliers that provide goods and services on credit during the pendency of the proceeding to ensure the continued operation of the debtor;

vi. permit and provide incentives for debtor-in-possession financing;

vii. allow the debtor to reorganize its operations, including by transferring assets or creating new entities, to encourage new investment and possibly the sale of assets free and clear of claims and encumbrances;

viii. permit the debtor to address and extinguish contingent claims, including claims by Republic creditors asserting that PDVSA is the alter ego of the Republic or otherwise seeking recourse against PDVSA's assets;

ix. permit the debtor to implement a reorganization plan as long as it obtains the requisite level of creditor support and meets certain minimum procedural and substantive requirements. Typically, in a judicial reorganization proceeding voting threshold requirements would only "count" those who participate in a creditor meeting or vote (which effectively means that the percentage of creditors required to support the transaction is less than would be the case in a typical

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whether to clean up their balance sheet, to attract new investment or to optimize their operations for better service to their customers or rate payers. In Puerto Rico, the Government is transforming its electric sector through a process that will be facilitated by the use of a reorganization statute that shares many of the characteristics of the law described in this article. See Richard Cooper, Luke Barefoot, Adam Brenneman and Antonio Pietrantoni, *Turning Bust To Boom*: *P3 Initiatives Under PROMESA* (July 19, 2017).

[15] See Mark Walker and Richard Cooper, *Venezuela's Restructuring: A Realistic Framework* (Sept. 19, 2017) for more information on potential objections to Chapter 15 recognition.

exchange offer and consent solicitation) and would allow for a "cram down" or "cram up" of various creditor classes preventing a single class (or even multiple classes) of creditors from blocking the approval of a plan as long as certain minimum conditions are met;

x. allow the plan to include incentives – in the form of priority or improved treatment or other means—to compensate creditors that commit new money as part of the consummation of any debt restructuring;

xi. establish a dedicated and independent Venezuelan court to administer the Venezuelan Public Sector Revitalization Law, possibly with the power and authority to appoint mediators and other experts (including international insolvency experts) to assist the court in its duties and foster settlements among parties;

xii. provide judicial and legislative tools to enable the debtor to seek recoveries from third parties, including corrupt government officials and others actors who defrauded PDVSA; and

xiii. recognize cross-border restructurings under the laws of other jurisdictions as a matter of reciprocity so that the new Venezuelan law and any resulting plan of reorganization will be recognized in multiple jurisdictions outside Venezuela.

The Venezuelan Public Sector Revitalization Law should also include provisions designed to prevent affiliated parties of the debtor from voting their claims and ensure that creditors receive substantive and procedural due process (and that property interests are adequately protected). Venezuela also may decide to include sunset or other provisions in the law that would limit its use by public sector entities once they emerge from the process (or allow restructured entities to opt out of the insolvency regime post-reorganization) so their future access to the capital markets is not negatively affected by the law.

We believe that the mere announcement of this law, which could be enacted by the National Assembly even as the Maduro regime clings to power, will be viewed as a positive signal to the investment community and could ignite a process of cooperation, and possibly even interim funding by the private sector, while Venezuela addresses the very real humanitarian, economic and social challenges it faces.

IV. THE BENEFITS OF THE LOCAL REORGANIZATION LAW SOLUTION

The Local Reorganization Law Solution provides a Venezuelan-centered, as opposed to U.S.-centered, approach to resolving PDVSA's debt issues. Although the law itself and the jurists that would administer and oversee it would no doubt need to conform to international standards in order for the law to be recognized and enforced outside Venezuela, the process and plan would be dictated by PDVSA and its creditors and not by policy makers in the U.S. To be recognized outside Venezuela, the law would necessarily have to provide creditors a meaningful role in approving, if not helping to shape, a reorganization plan for PDVSA, and in so doing it would lay a durable foundation for PDVSA's revitalization.

Adopting such a law and making it the basis for PDVSA's restructuring would carry with it a number of advantages, most of which would not be possible if Venezuela were to rely on the Executive Order Solution.

a. Upsides to the Local Reorganization Law Solution

i. At the culmination of the proceeding under the Venezuelan Public Sector Revitalization Law, once a plan is approved, if enforced in the U.S. and elsewhere through Chapter 15 and other similar processes, it would provide a full discharge of all claims against PDVSA within and outside Venezuela (including claims against PDVSA brought by Republic creditors based on alter ego or other similar claims) and would allow PDVSA to raise new capital free from the risk of interference by any holdout creditors, wherever located. The permanent discharge of claims and ongoing protection of assets from legacy claims is critical, as it is difficult to imagine strategic partners or new money investors being willing to make long-term investments in PDVSA without a high degree of certainty that unresolved claims —even if stayed and neutralized during the pendency of a U.S. Executive Order—will not come back to undermine and adversely affect PDVSA's operations and balance sheet. By their nature, debt and capital investments in oil and gas entities are long-term, and if the lessons of Argentina reveal anything, they demonstrate that holdouts can have a substantial impact on a debtor's activities and operations many years after their claims first matured. In contrast, the Executive Order option would neither bind holdouts nor provide a discharge of claims and liabilities (many of which will continue to accrue interest at high rates). And unlike the Venezuelan Public Sector Revitalization Order, the Executive Order Solution would do nothing to deter and prevent attempts by creditors to disrupt or interfere with payments made on restructured debt as did vulture investors in Argentina.

ii. The protection of assets and PDVSA's ability to conduct business on a world-wide scale would be of immense benefit to PDVSA and contrasts starkly with the U.S Executive Order Solution that would only protect assets physically located in the U.S. and only as long as the U.S. Executive Order remains in effect (whether expiration or withdrawal of the Order is due to changes in the willingness of the U.S. Government to maintain the Executive Order or to legal challenges brought against it by aggrieved investors).

iii. We would expect the Venezuelan Public Sector Revitalization Law to protect critical suppliers and counterparties of PDVSA that continue to provide goods and services to PDVSA during the pendency of the proceedings by granting their new claims priority or other special status that would ensure they come ahead of antecedent claims by unsecured creditors. This sort of protection is the lifeblood of commercial enterprises subject to financial stress, whether inside or outside a formal insolvency proceeding, and could ease PDVSA's short-term cash needs, allowing Venezuela to redirect such funds for other purposes.

iv. We would also expect the Venezuelan Public Sector Revitalization Law to contain customary provisions to provide similar incentives and benefits to parties that are willing to provide working capital or capital funding to address PDVSA's immense capital needs, possibly even during the pendency of the proceeding. Given the urgent need for such financing and the tremendous benefits that would flow to all stakeholders from restoring PDVSA's productive capacity, such incentives—which could come in the form of DIP financing—could be

game changers in the ability of PDVSA to resume and restore its operations and generate much needed foreign currency. Indeed, it would not be surprising were such a mechanism to be incorporated if existing PDVSA creditors welcome the opportunity to participate in such financing, particularly if offered improved treatment over other claimants who choose to sit on the sidelines.

v. Although it is premature to speculate as to what a plan of adjustment based on the Venezuelan Public Sector Revitalization Law might look like, we imagine that it might contain some or all of the following features:

A. the provision of new money "exit" financing, perhaps through some type of co-financing facility under which existing private sector creditors would be given a financial incentive to participate in a new money financing alongside multilateral institutions or where existing creditors would be offered an incentive to "roll up" some portion of their existing claims on favorable terms for each dollar of new money advanced;

B. different recoveries for different categories of creditors. The ability of a debtor to classify creditors in different classes and provide differentiated treatment of their claims typically provides a powerful tool to bring otherwise recalcitrant creditors to the negotiation table. In the case of PDVSA, there may be creditors who either view themselves as exempt from any obligation to negotiate because of their status (state-owned enterprises) or the nature of their claims (secured claims). For example, one can imagine creating a separate class of claims and differentiated treatment for contractual counterparties that have had their oil sales agreements rejected because their contracts imposed non-market terms on PDVSA. Similarly, one could expect that the claims of secured parties—such as PDVSA's 2020 bonds and its secured debt to Rosneft—would receive differentiated treatment while at the same time being subject to "cram up" provisions that could enable PDVSA to reinstate such debt with new and longer maturities at different market interest rates;

C. court-approved settlements with counterparties, including possibly creditors of the Republic whose assets were expropriated, that could be given effect even prior to the consummation of PDVSA's adjustment plan. Many of the strategic investors that have asserted valid expropriation or arbitration claims against Venezuela or PDVSA might be willing to settle their disputes in consideration for an opportunity to participate in PDVSA's or the private sector's revival. Such court-approved settlements could provide incentives for strategic investors to reinvest in Venezuela and rely on enforcement mechanisms and direct undertakings from the State (including non-impairment protections) that could fast track disputes and have binding effect within and outside Venezuela in specialized courts or arbitral tribunals created as a result of the new Law; and

D. mechanisms for creditors to obtain, on a contingent basis, additional recoveries over and above their restructured debt due to increases in oil prices beyond some agreed levels or outperformance as measured by some other parameter or macroeconomic variable.

An Executive Order, of course, would not provide a framework or means to do any of the above.

b. The Executive Order Approach

The Executive Order Solution relies on the strength of the U.S. Government to deprive bondholders of their ability to enforce their contractual and legal rights. As a temporary measure to allow a new Venezuelan government time to enact a new Venezuelan Public Sector Revitalization Law or to avoid costly litigation while the Republic formulates and conducts an offer to its own creditors, one can imagine the utility of a measure essentially operating as an automatic stay on suing the Republic or PDVSA or seeking to enforce claims against its assets. Indeed, in many respects it could be viewed as a continuation of the policies underlying current OFAC sanctions. However, we do not believe the unrestricted, ambiguous and indeterminate use of such a measure is in either Venezuela's interest or the interests of its stakeholders.[16]

First and foremost, an Executive Order puts the U.S. Government in the role of deciding what is best for Venezuela and what is fair and appropriate for creditors. Having the restructuring of Venezuela and its most important public sector borrower essentially determined by public officials in Washington, D.C. will not be helpful to any Government in Venezuela nor will it lend legitimacy or stability to a process that could easily extend beyond any one administration in Washington, D.C. or Caracas.

Second, it offers Venezuela none of the benefits of the Venezuelan Public Sector Revitalization Law: no mechanism to promote the provision of trade or other credit during the pendency of the restructuring process or upon PDVSA's exit from the proceeding; no means to adjudicate spurious claims; no enforceable legal process for rejecting burdensome long-term commitments; no mechanisms to deal with recalcitrant creditors whose status or claims might insulate them from negotiations; and no specific judicial tools to trigger the enforcement powers of courts within and outside Venezuela to recover the billions of dollars that have been stolen from PDVSA or gained through criminal enterprise to the detriment of all stakeholders.

Third, because it lacks any legal means to eliminate holdouts, but rather employs *in terrorem* means to avoid holdouts, it will jeopardize PDVSA's future access to the capital

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[16] Nor is it self-evident that it would be in the interests of the U.S. from a public policy perspective. The legal risk to the U.S. of an Executive Order, coupled with some of the other features mentioned by Buchheit and Gulati, is materially different from the cases they cite as precedent. And the facts and circumstances differ as well. With respect to Iraq, the effect of the world-wide freeze of Iraqi assets was to permit Iraq to offer take-it-or-leave-it restructuring terms to some 600 financial and commercial creditors with approximately $21 billion in aggregate claims. Although holders of 96% of claims against Iraq accepted Iraq's offer, Iraq was shut out of the international debt markets for over 10 years from the time the freeze was implemented. Venezuela cannot afford a solution of that sort. In the case of Iran, the situation bears little resemblance to the situation in Venezuela. The executive order in the case of Iran ensured that all would-be U.S. litigants still received their "day in court", albeit before an arbitral tribunal perhaps with a less U.S. creditor-friendly disposition. The affected U.S. creditors were also significantly benefited by the fact that formerly blocked Iranian assets were earmarked and secured in an escrow account in Algeria for the purpose of satisfying claims, which proved sufficient to pay in full the more than $2 billion in awards obtained by U.S. creditors. Thus, the Iran example involved no debt restructuring at all, but merely the adjudication of claims in an alternative legal forum and the provision of substitute security.

markets and new investment. Indeed, it may even expand the number of holdouts as creditors may be reluctant to participate in any exchange offer and consent solicitation if there is a risk that by doing so they will forego possible recoveries against the U.S. Government based on alleged violations of the U.S. Constitution for takings and other claims.[17]

The success of Venezuela's efforts to rebound from the disastrous policies of the Maduro regime will require not only massive amounts of private capital but also a renewed commitment by the new Government of Venezuela to the rule of law, transparency and respect of the rights of creditors and investors. Promoting or relying on the Executive Order Solution with an indefinite stay intended to tip the negotiating scales in one direction is incompatible with those principles.

V. RESTRUCTURING CLAIMS AGAINST THE REPUBLIC

As we have stated above, we believe that restructuring negotiations between the PDVSA bondholders and Venezuela should be conducted in tandem with the negotiations between Republic bondholders and Venezuela.[18] We further believe that the conclusion of any agreement with either set of bondholders should naturally be conditioned on agreement with the other group. This is so not only because many large bondholders hold both Republic and PDVSA bonds but also because as a practical matter neither restructuring could be implemented in isolation. Moreover, following its past practice and policies, the IMF will not commit to grant Venezuela exceptional access to its resources unless it is able to conclude "with a high degree of certainty" that Venezuela's debt is sustainable—a conclusion that can only be reached if both PDVSA and Republic debt are restructured on terms consistent with debt sustainability. In the case of Venezuela, where bond debt is one-third or less than the country's estimated foreign liabilities, it will also be necessary to strike arrangements with other large creditor classes. In the case of PDVSA, this should happen naturally within the scope of the Venezuelan Public Sector Revitalization Law. In the case of the Republic, bilateral debt will be dealt with in part through the Paris Club and in part through direct negotiation. Expropriation claims will be litigated through arbitral tribunals and the courts, though strategic investors asserting these claims are likely to be more inclined to settle their claims as a result of the enactment of the Venezuelan Public Sector Revitalization Law, which will cut off their ability to recover judgments based on the assets of PDVSA outside Venezuela (based on some alter ego or other legal theory) while at

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[17] The Supreme Court has recognized that secured creditors, such as the PDVSA 2020 bondholders, have a property right for which they are constitutionally entitled to protection to the extent of the value of their property. *Wright v. Union Cent. Life Ins. Co.*, 311 U.S. 273, 278 (1940). Moreover, where the President issues a stay with no alternative forum for creditors to bring claims of adequate protection or to generally be heard, there are arguments to be made that such actions are unconstitutional because they could lead to the destruction of the claim. *See Dames & Moore v. Regan*, 453 U.S. 654, 686-87 (1981) (the President's suspension of claims under an Executive Agreement with Iran was constitutional in part because the President provided an alternative forum "which [was] capable of providing meaningful relief").; *E-Systems, Inc. v. United States*, 2 Cl. Ct. 271, 272 (Fed. Cl. 1983) (holding takings claim was not ripe to be heard because the underlying claim had to be exhausted before the Iran-United States Claim Tribunal); *Ambac Assur. Corp. v. Comm. of P.R.*, 297 F. Supp. 3d 269, 277 (D.P.R. 2018) (holding takings claims asserted against fiscal plan proposed by Puerto Rico was not ripe because Puerto Rico had not made a final decision with regards to how it was going to disburse funds).

[18] This suggestion is not dependent on our working assumption that Republic and PDVSA bonds will restructured on the same terms.

the same time offering them protections and incentives to reinvest in a healthy oil and gas sector and a legal regime that respects property rights.

The simultaneity of negotiations is not incompatible with the fact that PDVSA will act within the framework of the Venezuelan Public Sector Revitalization Law, whereas there is no judicial reorganization process that would apply to the Republic's debt. In each case, a predicate to a successful conclusion of the process is agreement between PDVSA and a very large majority of its creditors, on the one hand, and between the Republic and a very large majority of its creditors on the other hand. With revenues from hydrocarbon resources, be they export sales, royalties or taxes constituting more than 95% of the country's foreign exchange earnings, it is inescapable that absent both sets of agreements there can be no satisfactory resolution of the country's external indebtedness. There is no getting around this fundamental conclusion, but that should not be a source of despair. It is clearly in the interests of all parties to reach agreement. And bondholders will be well advised to negotiate as a unified group (even if they conclude that PDVSA and Republic bondholders should be treated differently). It is important to bear in mind that the true holdout problem is not that Venezuela will not be able to reach agreement with the vast majority of its creditors, but that, having done, so an important minority will seek to remain outside the deal and secure better terms for themselves through litigation and disruptive behavior.

For PDVSA, this risk should be neutralized by virtue of the facts that dissenting creditors are bound by the restructuring plan and any remaining legacy claims will be discharged on confirmation and implementation of the plan.

For the Republic, however, it will be necessary to resort to more traditional incentives and disincentives to corral would-be holdouts into agreement and neutralize the impact of those that stay out.

As challenging a task as it will be, historically, sovereigns faced with a similar mix of debt (unsecured bonds, bilateral debt, arbitration and litigation clams and awards) have been able to restructure the vast majority of their debt using traditional techniques and have managed to protect their critical assets located outside their borders. The fact that PDVSA's assets will be protected by the Venezuelan Public Sector Revitalization Law and Chapter 15 will be of critical importance in this regard, adding considerable armor to conventional techniques of exit consents, exchange offers and other structuring tools.

a. Prerequisites to a Successful Transaction

Let us assume that Venezuela and its bondholders act responsibly and in good faith and that through a transparent process they agree on a fair and inclusive restructuring plan that is consistent with the country's IMF program and will support recovery of the economy. How can the Republic deal with creditors that would rather seek preferential treatment than join the restructuring?

In our view, a successful restructuring of the Republic's bond debt will require an innovative approach that links the Republic and PDVSA restructurings as well as the inclusion of features that seek to drive participation rates higher while making holding out costlier and less

attractive for dissenting creditors. We outline below a series of measures that we believe should together provide powerful incentives that will help to minimize holdouts.

b. Linkage to PDVSA Restructuring

As a first step, the terms of the PDVSA restructuring plan might require that PDVSA creditors who wish to consent to the plan must also agree to tender their Republic debt in the exchange offer launched to effect the restructuring of that debt. Given substantial cross-holdings, this feature of the PDVSA restructuring could prove quite helpful.

Similarly, we would propose that the PDVSA restructuring plan include a condition to its effectiveness that a specified percentage of Republic bondholders agree to the parallel restructuring of that debt. Indeed, it might even be possible for Republic creditors to participate in the PDVSA restructuring plan by exchanging their bonds for new PDVSA securities issued by PDVSA itself or by an entity created by it for this purpose. The tendered Republic debt would remain outstanding, perhaps held by PDVSA or placed in a creditor trust so that other features (*e.g.* voting and distributions in respect of the trust's assets) described below can be utilized to deter holdouts and benefit Republic creditors that participate in the exchange.

Finally, we envisage that the terms of the Republic and PDVSA restructurings might include distributing to participating bondholders a combination of Republic and PDVSA obligations together with an instrument providing for additional contingent payments based on Venezuela's capacity to pay as measured by oil prices or volumes or some other proxy for outperformance. The package offered to creditors who sign on before the closing of the exchange might by design differ from, and be superior to, that offered to creditors who join at a later date.

c. Exchange Offers, Exit Consents and Collective Action Clauses

The mechanism used to carry out a restructuring of sovereign bonds is an exchange offer, whereby holders of outstanding debt to be restructured are invited to exchange that debt for new bonds whose terms reflect the agreed restructuring terms. To encourage holders to tender, the sovereign debtor may ask tendering holders not only to participate in the bond exchange but also to amend the terms of the existing bonds, which are not tendered in the exchange and will remain outstanding so as to delete a number of protective provisions. If the exit consent (which is an agreement to amend the terms of the existing bonds that will remain outstanding after the exchange) is successful, non-tendering holdout creditors will be left holding an inferior and less valuable instrument post exchange. In the case of the Republic, we advocate being as aggressive as possible without jeopardizing the ability to sustain the exit consents against the inevitable legal challenges that will be brought. Thus, we would propose, among other things, that, to the extent permitted by the terms of the underlying documents and subject to obtaining sufficient consents, events of default and remedies (such as acceleration) be limited or qualified, the negative pledge clause be eliminated or cut back and waivers of sovereign immunity and other protective provisions be narrowed or eliminated. The reality is, however, that the voting requirements for many of the exit consents that are most likely to deter holdouts will require a

substantial supermajority vote.[19] This obviously could make it challenging to effect exit consents in certain series.

We also propose introducing a "sharing clause" into the old bonds that would require all non-tendering holders of a series of bonds to "share" with all other holders of the same series of bonds (including any affiliate of the issuer) any recoveries they receive from litigation, settlement or otherwise that are not paid equally to the other holders. To add to the power of the sharing clause, we would organize the exchange offer so that the tendered debt remains outstanding and held by a creditor trust for the benefit of those Republic bondholders who participated in the restructuring (or, as noted above, by PDVSA itself or an entity created by it). The trust would thus be entitled to share in any recoveries received by a holdout creditor and could distribute any amounts received in this capacity as a prepayment of principal of restructured Republic bonds. Leaving tendered Republic bonds outstanding would have the further benefit of diluting the voting power of the holdouts and, if less than 25%, their ability to accelerate.[20]

The effect of these exit consents and the introduction of a sharing clause would be to create incentives for Republic bondholders to participate in the exchange both because their ability to enforce their rights would be diminished and because they would be required to share any recoveries they might succeed in obtaining through litigation or otherwise with all other original bonds.

Most sovereign bonds issued today include collective action clauses ("CACs") that allow a super majority of holders across multiple series of bonds to agree to the terms of a restructuring that would be binding on all creditors. Unfortunately, the outstanding bonds of the Republic do not include these modern CACs which permit aggregated voting across series. Two issues of Venezuela's bonds do not contain CACs at all and the balance include CACs that allow holders of 75% (85% in the case of two issues) of the outstanding amount on a series-by-series basis to modify the basic payment and other terms to accommodate the restructuring that Venezuela will require. These are high thresholds and recalcitrant creditors may already have blocking positions in a number of series, or at today's prices (assuming U.S. sanctions permit trading to resume normally) might easily acquire such positions. Moreover, the use of CACs to restructure bond debt will have no impact on those holders that have already obtained money judgments by the time the CAC is activated. So, although it is possible that the existing CACs may be sufficient to lock in a restructuring for certain series, it is unlikely that they will prove effective on their own to restructure the Republic's bond debt.

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[19] For most of its bond debt, the Republic would need the consent of at least 66 2/3% of the aggregate principal amount of each series of its outstanding bonds to modify its terms but many of the more impactful changes referred to above require the consent of 75% or 85% of each series. Included in these higher vote "reserved matters", in addition to core payment and financial terms, are terms such as governing law, waiver of sovereign immunity, ranking and, in connection with certain exchange and tender transactions, events of default. For two series of bonds that do not have collective action clauses, the general voting/consent requirement is the lesser of (i) a simple majority of aggregate principal amount of outstanding bonds and (ii) 66 2/3% of aggregate principal amount of each series of its outstanding bonds represented at a meeting, but any amendment of "core payment and financial terms" would require unanimous consent of the holders of such series.

[20] The voting requirements for the addition of such a sharing clause would likely be an issue that would be litigated as it isn't specifically addressed in the documentation.

d. Other Incentives and Disincentives

In light of the high thresholds and series-by-series voting for exit consents and CACs (where they do exist), the Republic will need to consider what other targeted measures it could take to discourage holdouts. Some ideas worth considering are included below:

i. Subordination of Restructured Bonds – The Republic's Unusual Pari Passu Provisions. If as part of the restructuring of Venezuela's debt the Republic could subordinate (or threaten credibly to subordinate) holdout debt, holders that otherwise might be inclined take their chances and not participate in the restructuring may elect to participate for fear of being left behind in a worse position as a future holdout. This, of course, is not a novel idea. Certain sovereigns have sought to do this (or threatened to do this) in different ways, and some of the more aggressive exit consent strategies implicitly include this threat. But ever since the *NML* decision in Argentina, sovereigns that have had debt with *pari passu* provisions have been reluctant to do this for fear of finding themselves, like Argentina, unable to service their restructured debt. In the case of Argentina, a group of holdout creditors successfully argued that Argentina had violated the *pari passu* clause by paying creditors who had exchanged their defaulted debt for new debt, while at the same time refusing to pay holdouts on the legacy debt and acting legislatively to subordinate that debt. The court issued injunctions requiring Argentina to make "ratable payments" to holdouts each time payments were made to holders that had participated in an exchange offer.[21]

But the *pari passu* provisions in most of the Venezuela's bond documentation contain very unusual language not contained in Argentina's, nor in most other, sovereign bond documentation. The relevant language explicitly states that the Republic's unsecured debt cannot be subordinated "save for such exceptions as may be provided by applicable legislation".[22] Rather than protecting holders of such debt against subordination, the language explicitly contemplates the possibility that the bonds can be subordinated if Venezuelan law provides for such subordination.[23]

Consistent with the terms of such bond documentation, the Republic could adopt legislation prior to the launch of an exchange offer to provide a powerful incentive for potential holdouts to participate in the restructuring. This legislation could be expressly limited to subordinating any Republic bonds that remain outstanding after the closing of an exchange offer that exceeded some specified participation level and whose subordination is permitted by the terms of the underlying documentation. As a result, any new debt issued by the Republic as part of an exchange would be senior to holdout debt (the nature and extent of the subordination will no doubt be an issue to be determined at the time a transaction is agreed). Although there may be

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[21] *NML Capital, Ltd. v. Republic of Argentina*, 727 F.3d 230, 238, 241 (2d Cir. 2013). Ultimately, the court vacated the injunctions noting that "the injunctions were a discretionary remedy, not a legal entitlement" under the *pari passu* clause, but so held only after Argentina settled with the majority of its holdout creditors. *NML Capital, Ltd. v. Republic of Argentina*, No. 08-CV-6978 (TPG), 2016 WL 836773 at *11 (S.D.N.Y. Mar. 2, 2016).

[22] This language is not included in the documentation for the two series of Republic bonds that require unanimous consent to amend core payment and financial terms.

[23] Although PDVSA's bond documentation includes similar language, the Local Reorganization Law Solution addresses the risk of holdout creditors of PDVSA.

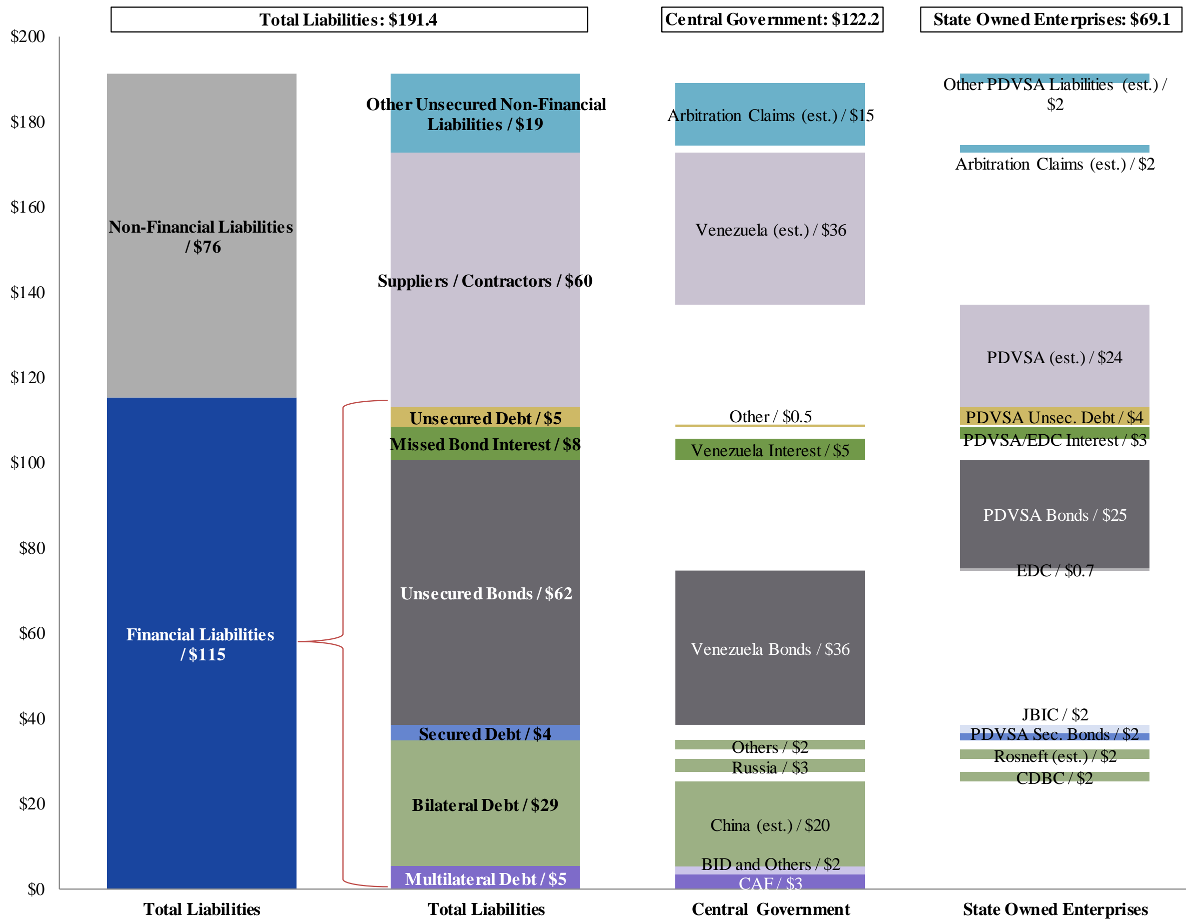
some legal risk to this approach, unlike in the case of Argentina's bond documentation, the plain language of the Republic bond documentation would seem to permit it.

ii. Debt-to-equity swaps. A limited and targeted debt-to-equity swap program, available only to creditors who participate in the Republic and PDVSA restructurings at the outset could be beneficial to both creditors and Venezuela, and provide an additional incentive for holders of Republic bonds to join a restructuring. The program would permit restructured debt to be tendered at market value (based on trailing average prices over, say a 90-day period), which could be used to purchase selected assets from the government. These assets could include rights to explore for and produce oil and gas as well as productive assets in other sectors in the hands of the government. Any participant in the program would be required to make a binding commitment to invest (in hard currency) not less than a minimum specified amount on or before specified dates in order to make the asset productive. Failure to invest would result in forfeiture of the investment. From the government's perspective, the program would enable it to retire debt at prices that would not be increased by virtue of its buying an equivalent amount of debt in the market and, from the investor's perspective, it would not risk lower prices by efforts to sell the debt for cash. Only restructured debt itself, and not value recovery instruments, would be eligible for the program.

VI. CONCLUSION

We believe the enactment by Venezuela's National Assembly of a Venezuelan Public Sector Revitalization Law, complemented by proceedings in the United States and elsewhere under Chapter 15 of the U.S. Bankruptcy Code and equivalent legislation, provides an elegant and valuable framework for resolution of PDVSA's external liabilities. Resolution of the external liabilities of the Republic presents a more difficult challenge, but one that has been successfully met by other sovereign debtors in the past whose situation does not differ that greatly from that of Venezuela. And the fact that PDVSA's assets and revenues can be protected will be a critical factor in discouraging Republic creditors from seeking to hold out and obtain preferential treatment for themselves, as their ability to recover on their claims outside a restructuring will be severely limited. To ensure the maximum level of participation in a restructuring of the Republic's debt, we recommend that Venezuela deploy a combination of techniques—exit consents, structuring options and positive and negative incentives—whose design will require a great deal of thought. It is important to note that this exercise is not one that Venezuela will be required to undertake on its own. The contours of a restructuring of the Republic's and PDVSA's external obligations will in the first instance be negotiated and agreed with a substantial majority of the country's creditors, ideally with the support of a highly motivated and influential creditor committee, as well as the United States and other interested nations, the IMF and other international financial institutions and the international community generally.

Annex A: Summary of Venezuela's External Liabilities



Source: PDVSA's audited financial statements, National Office of Public Credit ("ONCP") Reports, Ecoanalitica, court filings, other financials and news sources. Excludes all internal liabilities denominated in Bolivares. Government guaranteed loans are excluded due to lack of available data.