Dechert LLP

ONPOINT / A legal update from Dechert's International Trade Group

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U.S. Escalates Sanctions Against PdVSA, Venezuela

On January 28, 2019, the United States imposed blocking sanctions on Petróleos de Venezuela SA ("PdVSA"), the Venezuelan state-owned oil company. The measures follow President Trump's recent decision to recognize Juan Guaidó, the opposition leader, as Venezuela's legitimate head of state, and are an attempt to force new elections by starving President Nicolás Maduro and his regime of cash. The sanctions block all of PdVSA's assets in, and prevent PdVSA from selling oil to, the United States, although several authorizations were also issued to mitigate the immediate impact on U.S. companies and investors.

Summary

Although the U.S. Treasury Department's Office of Foreign Assets Control ("OFAC") has maintained limited sanctions on PdVSA since 2017 (prohibiting certain dealings in debt and equity instruments), the sanctions imposed on January 28 are comprehensive. Persons subject to U.S. jurisdiction are broadly prohibited from doing business with PdVSA or dealing in any property in which PdVSA has an interest. While bondholders can continue to hold such interests, they cannot purchase new debt or equity interests or sell such interests to U.S. persons. Companies that have other commercial dealings with PdVSA must generally wind down that activity within several months. The sanctions are likely to significantly impact trading in PdVSA securities and to curtail the company's ability to operate, even in non-U.S. markets.

What Changed

OFAC designated PdVSA pursuant to Executive Order ("E.O.") 13850, on the basis that it operates in the oil sector of the Venezuelan economy. As a result, PdVSA is now on OFAC's Specially Designated Nationals and Blocked Persons ("SDN") List, which means U.S. companies are broadly prohibited from transacting with it, and all of its property that is in (or that comes within) the United States must be blocked and reported to OFAC. The same restrictions apply to any entity in which PdVSA has a 50% or more ownership interest. As described below, however, there are several exceptions to these general requirements that are important for U.S. investors that deal in PdVSA bonds and for other U.S. companies with commercial dealings with PdVSA.

This is a significant action against a major player in U.S. energy markets that has considerable exposure to and entanglements with U.S. companies and investors. Accordingly, OFAC also issued nine new and amended general licenses in order to mitigate the adverse impact on U.S. interests. As a result:

- **U.S. investors can no longer purchase PdVSA bonds but can hold or divest existing holdings.** U.S. persons can no longer purchase any PdVSA bonds, including on the secondary market, as a result of PdVSA's addition to the SDN List and OFAC's amendment to General License ("GL") 3, because such bonds are blocked property of PdVSA. However, GL 9 now authorizes U.S. persons to divest or transfer PdVSA bonds they already hold to non-U.S. persons, or to hold them indefinitely. Notably, there is no expiration or deadline for this authorization, so U.S. investors are under no obligation to sell and may face less immediate pressure to offload these assets. There also is no reporting requirement related to divestments or transfers conducted pursuant to this general license (unlike the reporting requirement involved in divestment or transfers of securities of certain Russian SDNs). Importantly, bonds issued by PdVSA subsidiaries PDV Holding, Inc. ("PDVH"), CITGO Holding, Inc. ("CITGO"), and their subsidiaries (including CITGO Petroleum Corp.) are exempt from these prohibitions, and U.S. persons can freely trade in instruments issued by these parties.

- **U.S. companies may purchase and import petroleum and petroleum products from PdVSA for a limited time, and may wind down other transactions.** Because of the spot trade in Venezuelan crude, OFAC issued GL 12 to authorize even new purchases and importations from PdVSA through April 28, 2019, provided that payments are made into a blocked account in the United States. The contracts or agreements do not have to be pre-existing the sanctions. Any other transactions involving PdVSA – including for the export of goods, services, or technology – must involve pre-existing operations, contracts, or agreements, and must be wound-down by February 27, 2019.

- **PdVSA's U.S. subsidiaries can continue operating.** Because OFAC sanctions extend to any entity 50% or more owned by an SDN, OFAC issued GL 7, which authorizes all transactions with PDVH, CITGO, and their subsidiaries, through July 27, 2019. In addition, PDVH and CITGO are authorized to purchase and import petroleum and petroleum products from PdVSA itself through April 28, 2019, provided that they make payments into a blocked account in the United States. This last condition is likely to accelerate PdVSA's search for non-U.S. customers and CITGO's hunt for alternative suppliers. Although the expiration dates in GL 7 mean that CITGO could become subject to blocking sanctions itself as soon as July, OFAC's precedent dealing with RUSAL suggests that it is driving for a more permanent solution before that date, and may be inclined to extend the authorizations in GL 7 for additional periods of time.

- **Certain U.S. companies operating in Venezuela can continue to transact with PdVSA**. OFAC identified five major U.S. companies that have significant investments in Venezuela involving PdVSA – Chevron Corporation, Halliburton, Schlumberger Limited, Baker Hughes (a General Electric Company), and Weatherford International, Public Limited Company – and authorized them via GL 8 to engage in all otherwise prohibited transactions and activities necessary and ordinarily incident to their operations in Venezuela, through July 27, 2019. This does not authorize those companies to engage in new transactions with PdVSA in support of their U.S. business but does allow them to protect their investments in Venezuela.

- **U.S. persons who are employees and contractors of non-U.S. companies outside the United States can wind down transactions involving PdVSA**. Although non-U.S. companies are not strictly prohibited from dealing with PdVSA, U.S. persons who are employees and contractors – even those located outside the United States – would be barred from engaging in or facilitating such transactions. GL 11 authorizes those employees and contractors to wind down operations, contracts, or other agreements that were in effect prior to January 28, 2019, through March 29, 2019. This means, for example, a U.S. person employee of an oil trader based in London could execute upon a trade agreed upon prior to PdVSA's designation.

- **U.S. financial institutions are authorized to reject transactions between PdVSA and non-U.S. entities.** GL 11 also authorizes U.S. financial institutions to reject, rather than block, transactions involving PdVSA (and its 50% or more owned entities) and non-U.S. entities located outside of Venezuela through March 29, 2019, provided that the transfers originate and terminate outside the United States. This will mitigate the impact on dollarized third-country transactions involving PdVSA, but only for a limited time.

- **Nynas AB is excepted from the sanctions for a limited time.** U.S. companies are authorized by GL 13 to continue transacting with Nynas AB, a Swedish manufacturer of petroleum additives that is majority owned by PdVSA through July 27, 2019.

OFAC is expected to publish guidance in the near future regarding issues where there is currently ambiguity. For example, it is not currently clear whether existing holdings of PdVSA bonds must be treated as blocked property or if GL 9 permits treating such holdings as non-blocked property (thus avoiding a reporting requirement). It is also not clear if U.S. holders of PdVSA bonds are permitted to accept interest payments on their holdings or if such payments must be treated as blocked property and placed in a separate account.

What to Expect

The blocking of PdVSA represents a significant escalation of U.S. sanctions against Venezuela. The sanctions may be further complicated should Venezuela attack or forcibly dispel U.S. diplomats or other nationals from the country, as was threatened shortly after the Trump Administration's recognition of Juan Guaidó's opposition government. That is because the International Emergency Economic Powers Act ("IEEPA"), the basis for E.O. 13850 and other U.S. sanctions, authorizes the president to confiscate the property of foreign countries or nationals that attack the United States – theoretically including PdVSA's U.S. holdings, which are, for now, only frozen. The president used this authority in 2003 to seize and redistribute Government of Iraq property in the United States – although that was a much more clear-cut case under IEEPA.

Regardless, the relatively short deadlines in most of OFAC's general licenses suggest that the U.S. government expects the situation in Venezuela to resolve relatively quickly. Administration officials estimated the designation of PdVSA would block upwards of $7 billion in assets and deprive the Maduro regime of $11 billion in funds over the next year, a massive hit for the cash-strapped government. If Maduro hangs on, however, additional sanctions against the government – including via the expiration of the general licenses identified above – are anticipated.

How Dechert Can Assist

U.S. sanctions are becoming increasingly nuanced and varied, and the regulatory and enforcement risks associated with economic sanctions, asset-freezing measures and trade embargoes continue to grow in scope and complexity. Any company or person engaging in business involving Venezuela, including holding Venezuelan debt, should be aware of the ongoing developments in the U.S. sanctions landscape and the attendant risks to transactions. With sanctions, trade and government relations experts in both Washington and London, Dechert is available to advise regarding the impact of these changes and those still to come.

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