ALERT MEMORANDUM

OFAC Issues Guidance on PdVSA Designation and Further Restricts Dealings in Venezuelan Debt

February 4, 2019

On February 1, 2019, the U.S. Department of Treasury's Office of Foreign Assets Control ("OFAC") issued FAQs providing guidance on the designation of Petróleos de Venezuela, S.A. ("PdVSA") under Executive Order ("E.O.") 13850 and concurrent issuance of related general licenses.[1] OFAC also issued amended general licenses governing secondary trading of pre-sanctions Government of Venezuela ("GoV") and PdVSA debt (General License ("GL") 3B and 9A).

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KEY TAKEAWAYS

Highlights of the new OFAC guidance and license amendments include that:

- holders of the PdVSA 2020 8.5 percent bond, including U.S. person bondholders, are licensed to execute on the underlying collateral despite the blocking of PdVSA property under GL 9A;
- authorized trades in pre-sanctions GoV bonds pursuant to GL 3B are now limited to sales to non-U.S. persons, as was the case for PdVSA bonds;
- technical fixes were added that are designed to permit settlement of open trades and securities transactions if the transactions were entered into before the effective time of the relevant sanctions (4:00 pm NY time on January 28 for PdVSA entities, and 4:00 pm NY time on February 1 for other GoV entities), regardless of whether the transferee is a U.S. person;
- U.S. financial institutions' authority to reject (rather than block) "U-turn" funds transfers relating to PdVSA has been limited to maintenance or wind down activities involving U.S. persons authorized under GL 11, and all other unlicensed, PdVSA-related U.S. dollar clearing transactions must be blocked;
- U.S. and non-U.S. persons may continue to form and invest in funds providing synthetic exposure to PdVSA-related debt or equity where the underlying basket being tracked does not consist predominantly of blocked securities;

[1] *See* our prior alert memorandum, "U.S. Sanctions Venezuelan Oil Industry" (Jan. 29, 2018), *available at* https://www.clearygottlieb.com/-/media/files/alert-memos-2019/us-sanctions-venezuelan-oil-industry.pdf.

- Non-U.S. persons can engage in transactions with a U.S. nexus to purchase PdVSA petroleum and petroleum products outside of the United States until April 28, 2019.

UPDATED AND NEWLY ISSUED FAQS

The new and amended FAQs provide significant detail on the impact of the designation of PdVSA and scope of the recently issued general licenses:

- Revised FAQ 595 clarifies that the authorization in GL 9 (superseded by GL 9A) for transactions and activities "ordinarily incident and necessary" to dealings in any debt or equity of PdVSA and its directly or indirectly owned 50% subsidiaries permits holders of the PdVSA 2020 8.5 percent bond (including U.S. person holders) to execute on the underlying collateral, despite the designation of PdVSA and resulting blocking of its assets within U.S. jurisdiction (which implies that all security interests relating to pre-sanctions PdVSA debt remain enforceable in the United States).
- Revised FAQ 648 clarifies that the authorization for maintenance and wind-down activities under GL 11 for U.S. persons who are employees or contractors of foreign entities dealing with PdVSA and its subsidiaries (and for wind-down activities within U.S. jurisdiction under GL 6, relating to Globovision) broadly permits operation in accordance with past practice as well as transitional activities through the expiration of the license. This is consistent with guidance provided for maintenance and wind-down activities under the Ukraine and Russia-related sanctions.
- FAQ 653 clarifies that U.S. and non-U.S. persons may continue to form and deal in investment funds that include synthetic risk in debt, equity or other holdings of blocked persons such as PdVSA and its directly or indirectly owned 50% subsidiaries, so long as the underlying basket being tracked includes less than a "predominant" share by value of such blocked debt, equity, or other holdings.
- FAQ 654 limits the authorization for U.S. financial institutions to reject (rather than block) "U-turn" funds transfers involving PdVSA or its subsidiaries in which both the originator and beneficiary were non-sanctioned, non-U.S. persons located outside the United States solely to funds transfers related to maintenance and wind down activities authorized under GL 11. In other words, the vast majority of U.S. dollar transactions relating to PdVSA or its subsidiaries clearing through the U.S. financial system must be blocked.
- FAQ 655 sets out the 90-day wind-down periods authorized by GL 7 and GL 12 to import petroleum and petroleum products from PdVSA and its subsidiaries to PDV Holding, Inc. and CITGO Holding Inc. and their respective subsidiaries and to U.S. persons generally, respectively, and clarifies that the wind-down provisions of GL 8 (relating to U.S. persons in Venezuela) and GL 10 (authorizing certain U.S. oil services companies to wind down operations in Venezuela) will continue to operate to permit authorized purchases following expiration of GL 7 and GL 10 on April 28, 2019.
- FAQ 656 clarifies that GL 10's authorization of the purchase of petroleum products from PdVSA or its subsidiaries in Venezuela for personal or commercial use, but not for resale, transfer, or export, permits refueling aircraft providing passenger or cargo services to and from Venezuela.
- FAQ 657 states that GL 12, paragraph (a) authorizes non-U.S. persons to engage in transactions with a U.S. nexus (e.g., involving dollar transfers through the U.S. financial system or U.S. commodity brokers)

to purchase PdVSA petroleum and petroleum products outside of the United States until April 28, 2019, despite GL 12's explicit reference to "purchase and importation into the United States."

- FAQ 658 interprets GL 7 and GL 12 together to authorize swaps and other non-cash transactions involving the purchase or exchange of PdVSA petroleum or petroleum products, but only until the expiration or termination of those licenses (and reminds participants of the requirement to place any proceeds, cash or otherwise, owed to PdVSA or any subsidiary into a blocked account).
- FAQ 659 states that the path to sanctions relief for PdVSA and its directly or indirectly owned 50% subsidiaries is through transfer of control to Interim President Guaidó or a subsequent, democratically elected government.

The new OFAC FAQs and previous Venezuela-related OFAC guidance are here.

AMENDED GENERAL LICENSES

I. GL 3B

GL 3B amends and replaces previously issued General License 3A by restricting the general authorization to trade in certain bonds issued prior to the imposition of sanctions on the Government of Venezuela (as specified in the annex to GL 3B) to only authorize divestment or transfer to non-U.S. persons. GL 3B and FAQ 662 also permit all transactions required to facilitate, clear, or settle trades in the bonds covered by GL 3B that were placed before 4:00 p.m., Eastern Standard Time on February 1, 2019 are authorized, even where such transfers are to U.S. persons. Similarly, transactions necessary for the wind down of financial contracts or other agreements involving such bonds that were entered into prior to 4:00 p.m. Eastern Standard Time on February 1, 2019 are authorized until March 3, 2019.

II. GL 9A

GL 9A amends and replaces previously issued General License 9 by expanding authorization to deal in securities of PdVSA and its directly or indirectly owned 50% subsidiaries issued prior to August 25, 2017, to include equity securities as well as debt securities, so long as any divestment or transfer is to a non-U.S. person. Additionally, GL 9A and FAQ 661 authorize all transactions required to facilitate, clear, or settle trades in PdVSA debt or equity covered by GL 9A that were placed before, or to wind down financial contracts or other agreements entered into prior to 4:00 p.m. Eastern Standard Time on January 28, 2019, even where transfer to a U.S. person is involved. U.S. persons may also engage in purchases or sales of PdVSA debt and equity with PdVSA or PdVSA subsidiaries to the extent necessary to the divestment or transfer of PdVSA securities to non-U.S. persons.

The revisions in GL 9A also include adding coverage for certain bonds issued by Petrozuata Finance Inc. that had been previously removed from General License 3 but not added to any other license, thus permitting dealings within U.S. jurisdiction so long as divestment or transfer is to a non-U.S. person. Additionally, certain Cerro Negro and CA La Electricidad de Caracas bonds were transferred from GL 3B to GL 9A (which has little practical implication other than clarifying which Venezuelan entity OFAC believes owns the issuers).

FUTURE IMPLICATIONS

It should be noted that any of these licenses can be amended or revoked, or the scope of blocked property extended, at any time. It is particularly noteworthy that OFAC has implicitly reaffirmed that a license is necessary to execute on collateral posted by PdVSA (or other blocked entities), including for pre-sanctions debt. Market participants should bear in mind that these licenses may be amended, supplemented, or revoked, and more generally that ability to trade, collect payment on, or enforce these obligations may be altered at any time pursuant to OFAC's blocking authority, as developments unfold.

With respect to the Crystallex litigation, OFAC's actions strongly suggest that Crystallex would not be authorized to execute against the shares of PDV Holding Inc. absent further licensing actions from OFAC. OFAC issued GL 5 in order to exempt the 2020 bonds from Subsection 1(a)(iii) of E.O. 13835, which otherwise would prohibit the transfer by the GoV of any equity interest in any entity in which the GoV has a 50 percent or greater ownership interest and, thus, execution against those assets. *See also* FAQ 595 and FAQ 596. Judge Stark left that possibility open in the rather spare analysis in his August opinion, [2] and the blocking of PdVSA only reinforces that conclusion under the plain language of OFAC's regulations. Blocking prohibits the unlicensed "transfer" of any property of PdVSA or its subsidiaries, and "transfer" is defined broadly to include "the creation or transfer of any lien; the issuance, docketing, or filing of, or levy of or under, any judgment, decree, attachment, injunction, execution, or other judicial or administrative process or order." 31 C.F.R. § 591.310;[3] *see also* 50 U.S.C. § 1702(b) (giving President the power to "nullify, void, prevent or prohibit, any acquisition, holding, withholding, use, transfer, withdrawal, transportation, importation or exportation of, or dealing in, or exercising any right, power, or privilege with respect to, or transactions involving, any property in which any foreign country or a national thereof has any interest").

OFAC stated in FAQ 595 that General License 9A's authorization of transactions "ordinarily incident and necessary to dealings in any debt (including the bonds listed on the Annex to this general license, promissory notes, and other receivables) of, or equity in, Petróleos de Venezuela, S.A. (PdVSA) or any entity in which PdVSA owns, directly or indirectly, a 50 percent or greater interest (together, PdVSA securities), issued prior to August 25, 2017" authorizes holders of the PdVSA 2020 bonds to "gain access to the…collateral," despite the otherwise-applicable blocking of PdVSA assets under E.O. 13850 However, it does not appear that the Crystallex claim is easily characterized as "receivables [of PdVSA or its subsidiaries]…issued prior to August 25, 2017," and it is uncertain whether OFAC would license attempts by Crystallex to execute on its judgment or take the view that they are prohibited, as appears to be the case on the face of the relevant regulations.

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[2] *See Crystallex Int'l Corp. v. Venezuela*, No. 17-mc-151-LPS (D. Del. Aug. 10, 2018), slip op. at 63-67.

[3] The Venezuela Sanctions Regulations technically have not yet been amended to refer to E.O. 13850, but this definition is standard across OFAC sanctions programs and is, in the agency's view, what the Executive Order means.