<u>Hitting the Brakes:</u>
How a Potential PDV Holding Bankruptcy Might Affect Venezuela and PDVSA Creditors

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Much has been written about the ongoing economic and financial crisis in the Republic of Venezuela, including its economic collapse, the shortage of basic food and medicine, the spread of poverty and disease and the mass exodus of its population.[2] In the midst of the collapse of this failed state, Venezuela also faces an ever widening battle with its creditors who are pursuing billions of dollars in claims in courtrooms within and outside the United States.[3]

At the center of its debt fight with its creditors is the Republic's national oil company, Petróleos de Venezuela, S.A. ("PDVSA"). PDVSA holds some of the Republic's most valuable assets, including ownership of CITGO Petroleum Corporation ("CITGO") through PDVSA's wholly owned subsidiary PDV Holding Inc. ("PDV Holding"). PDV Holding (and its valuable downstream subsidiaries) are now squarely in the sights of a number of Republic and PDVSA creditors, some of whom are poised to obtain judgments or court orders in the U.S. that could ultimately result in PDVSA losing CITGO. For PDVSA, protecting against the seizure of PDV Holding's interests in CITGO would seem to be of paramount importance: a successful exercise of remedies against PDV Holding's ownership interests could trigger change in control provisions in CITGO debt and initiate a value-destructive chain reaction that could result in PDVSA no longer controlling a key strategic asset.[4] This risk is no longer a theoretical one—two major claimants, Crystallex International Corporation ("Crystallex") and ConocoPhillips Co. ("ConocoPhillips"), could well be weeks or months from obtaining the necessary court approvals to initiate such actions. Further, PDV Holding pledged 50.1% of its shares in CITGO's parent company, CITGO Holding, Inc. ("CITGO Holding"), as security for $3.4 billion of PDVSA bonds due 2020 (the "2020 Bonds" held by "2020 Bondholders"), and the remaining 49.9% to PJSC Rosneft Oil Company ("Rosneft") as part of another PDVSA financing. Either pledge could be called upon if PDVSA defaults, most acutely on an $840 million amortization payment due to 2020 Bondholders in October 2018.

This article explores one dramatic option that the Republic and PDVSA could potentially take to forestall that result: a bankruptcy filing for PDV Holding under Chapter 11 of

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[2] *See* European Parliament Resolution on the Situation in Venezuela, (2018/2559(RSP)) B8-0078/2018.

[3] *See generally*, Mark A. Walker & Richard J. Cooper, *Venezuela's Restructuring: A Realistic Framework* (Sept. 19, 2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3039678.

[4] As a U.S. company, CITGO provides PDVSA with access to U.S. refineries for its crude oil as well as imported diluents, which are critical to ensuring that the Republic's heavy oil is readily exportable. As is often the case when it comes to Venezuela, there is an alternative view that CITGO may no longer be a critical strategic asset to Venezuela (or more accurately the Maduro regime) in light of the recent ConocoPhillips ICC award and U.S. sanctions, the fact that long-term offtake and supply arrangements will remain in place even after a change in ownership and that Venezuela is shifting its exports and imports away from the U.S.

the U.S. bankruptcy code (the "Bankruptcy Code").[5] Although clearly an option of last resort for the current Venezuelan regime, if made protectively, such a filing could provide PDV Holding with some breathing room to formulate a plan to safeguard its strategic interests, most notably its indirect ownership of CITGO, perhaps giving time for the Trump administration and/or the Venezuelan government to reset or modify their policies.[6] This article explores some of the key issues that could precipitate a potential PDV Holding bankruptcy. In addition, we address a number of potential disputes that likely will arise in connection with such a filing, including potential actions that key creditor constituencies could take in response to such a filing.

While this article focuses on how creditors might respond to a PDV Holding bankruptcy, we also try to consider what tactics PDVSA may deploy in anticipation of creditor challenges. One such tactic may be to seek to include PDV Holding's direct and indirect subsidiaries, most notably CITGO Holding and CITGO, as part of a broader Chapter 11 filing for PDV Holding and its subsidiaries. While doing so would not eliminate the legal risks associated with a PDV Holding filing, it would have two key advantages. First, it confers the benefit of the Bankruptcy Code's automatic stay provisions on PDV Holding's subsidiaries, which would prevent subsidiary creditors from taking advantage of cross-defaults or change in control protections in certain CITGO Holding and CITGO debt instruments which may be triggered by a PDV Holding filing or an attempt by PDVSA creditors to seize ownership of PDV Holding itself. Second, creditors of PDVSA would likely seek to dismiss a PDV Holding bankruptcy as having been filed in bad faith or under the doctrine of abstention. Defending against such a claim would be easier if CITGO Holding and CITGO are filed along with PDV Holding. This is because one of the arguments creditors are likely to make as part of their motion(s) to dismiss is that PDV Holding has no prospects for a successful reorganization given that restructuring PDVSA's debt is essentially impossible given current U.S. sanctions. Because PDV Holding itself has little to no debt or outstanding obligations aside from its stock pledges and no independent operations, it will likely need to rely on the reorganization prospects of CITGO Holding and CITGO to overcome likely efforts to dismiss the bankruptcy proceeding.

Finally, although a PDV Holding bankruptcy is the central premise of this article, it should be noted that it is unclear whether PDVSA would ultimately make the decision to file PDV Holding (or its subsidiaries) for bankruptcy. First, as discussed below, while PDVSA may argue otherwise, a PDV Holding bankruptcy and the automatic stay that it would effectuate is unlikely to protect PDVSA from the fundamental risk that Crystallex, ConocoPhillips or another Republic or PDVSA creditor could seek to satisfy its judgment or claim through execution on PDVSA's shares of PDV Holding. Second, if the Republic were able to forestall litigation seeking to seize PDVSA's PDV Holding shares, it might ultimately determine that PDVSA should make the October 2018 bond payment in order to prevent the 2020 Bondholders from

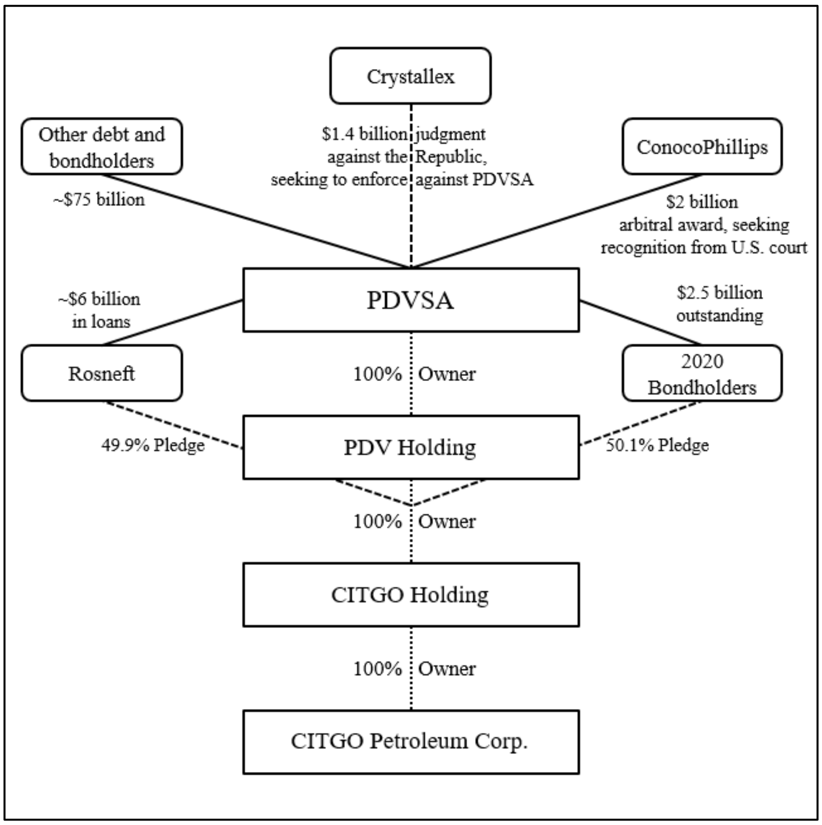
[5] Unrelated to the issues discussed in this article, on July 24, 2018, PDV Insurance Company Ltd., a Bermudian entity and PDVSA wholly owned subsidiary, filed for recognition of its Bermudian liquidation proceeding under Chapter 15 of the Bankruptcy Code. *See In re PDV Ins. Co., Ltd.*, Case No. 18-12216 (MEW) (Bankr. S.D.N.Y. 2018).

[6] Although most observers do not believe that regime change in Venezuela seems imminent or even likely for the foreseeable future, if and when it were to occur, it is likely to happen quickly and without much notice. *Cf.* Jason LeMiere, *Venezuela President Nicholas Maduro Targeted with Apparent Drone Assassination Attempt During Speech*, Newsweek, Aug. 4, 2018.

exercising their rights with respect to the PDV Holding pledge, eliminating a key triggering event for a PDV Holding bankruptcy.[7]

In the event PDVSA did pursue a bankruptcy proceeding for PDV Holding, and forestalled efforts to dismiss the proceeding, the central question will be how and under what circumstances PDV Holding can emerge from the proceeding. While PDVSA (and perhaps its bond creditors) will likely attempt to delay any final determination as long as possible, particularly as the exclusivity period begins to close, either PDVSA or its creditors may seek a Section 363 sale of CITGO Holding or the operating assets of its subsidiaries to ultimately realize value.

I. Key Players in a PDV Holding Bankruptcy



The above chart provides a simplified overview of the relationships between certain key players in a PDV Holding bankruptcy.

a. PDVSA and PDV Holding

Founded in 1976, PDVSA is the primary vehicle through which the Republic develops and monetizes its immense oil wealth. In more recent years, PDVSA has also become a key issuer of debt for the Republic. PDVSA has approximately $28 billion of bond debt and faces billions of dollars of other claims from vendors and other litigants (both actual and

[7] That said, it should be noted that the 2020 Bonds contain cross-defaults that could be triggered by, among other things, a court's issuance of a final judgment against PDVSA in excess of $100 million—something ConocoPhillips is currently in the process of seeking through its request for recognition of its arbitral award. *See infra* at 4-6.

prospective).[8] Given the policies of the Maduro regime, PDVSA's rapidly declining production and its inability to access the international debt markets, PDVSA's debt load is clearly not tenable and PDVSA generally stopped making payments on its debt late last year, with the exception of debt secured by shares of CITGO's indirect parent entity.

A U.S. bankruptcy of PDVSA, however, is not likely, both because it is difficult to see the Maduro government subjecting PDVSA—which owns valuable assets in the U.S. and abroad—to a U.S. bankruptcy court process and because PDVSA would likely be viewed by an American bankruptcy court as an instrumentality of a foreign state, and therefore ineligible for Chapter 11.[9]

By contrast, wholly owned PDVSA subsidiary PDV Holding is a corporation organized under the laws of Delaware and therefore eligible to file a Chapter 11 proceeding. PDV Holding's chief asset is its 100% ownership stake in CITGO Holding. As noted above, in 2016, PDV Holding pledged 50.1% of its shares of CITGO Holding as security for the 2020 Bonds. The remaining 49.9% was pledged shortly after the 2020 Bond issuance as security for a financing transaction between PDVSA and Russian oil company, Rosneft.

Although the Republic and PDVSA have strategically defaulted on nearly all of their bonds, PDVSA continues to make payments to the 2020 Bondholders, hoping to dissuade the 2020 Bondholders from exercising remedies as to PDV Holding's pledge of its shares in CITGO Holding. The next scheduled payment on the 2020 Bonds, a substantial $840 million amortization payment, comes due in October 2018. Holders and analysts continue to speculate about whether PDVSA will make the payment, particularly as the Republic's economic woes deepen and creditors continue their efforts to collect on their debts as discussed below.

b. Major Creditor Constituencies[10]

i. ConocoPhillips

In the late 1990s, subsidiaries of ConocoPhillips entered into two ventures with PDVSA to produce, transport and sell extra-heavy crude oil in Venezuela. Between 2001 and 2007, the Venezuelan government effectively nationalized the oil industry and expropriated Conoco's interests in the two projects. Following that expropriation, Conoco commenced two arbitrations: one against the government of Venezuela before an International Centre for Settlement of Investment Disputes ("ICSID") tribunal for claims under the Venezuela-Netherlands bilateral investment treaty, and the other against PDVSA and its subsidiaries before an International Chamber of Commerce ("ICC") tribunal for claims arising out of the contracts for the two ventures.

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[8] *See generally*, Mark A. Walker and Alice Chong, *Restructuring Certain Debt of the Republic of Venezuela and PDVSA on the Same Terms*, (Mar. 12, 2018), available at http://www.millsteinandco.com/images/pdfs/restructuring%20certain%20debt%20of%20the%20republic%20of%20venezuela%20and%20pdvsa%20on%20the%20same%20terms.pdf.

[9] *See* 11 U.S.C. §§ 101(27); 101(41); 109(a). The Republic is, of course, a foreign state and therefore statutorily ineligible for Chapter 11 protection. *Id.*

[10] For a more fulsome examination of creditors of the Republic and PDVSA *see* Richard J. Cooper & Boaz S. Morag, *Start Your Engines: Are We Going to See More Creditor Recovery Efforts in Venezuela?*, (May 29, 2018), https://www.clearygottlieb.com/-/media/files/start-your-engines-are-we-going-to-see-more-creditor-recovery-efforts-in-venezuela-5-29-18-pdf.

On April 24, 2018, the ICC tribunal issued an award in favor of ConocoPhillips against PDVSA directly in the amount of nearly $2 billion, plus post-award interest (the "ICC Award").[11] Upon receiving the ICC Award, ConocoPhillips immediately commenced an enforcement action in the U.S. District Court for the Southern District of New York on April 26, 2018, and sought to obtain a U.S. court judgment recognizing the arbitral award.[12] This proceeding requires ConocoPhillips to serve PDVSA under the U.S. Foreign Sovereign Immunities Act (the "FSIA"), and allows PDVSA at least 60 days to respond, which has not yet started to run because service has not yet been effected on PDVSA. To date, ConocoPhillips has not sought a pre-judgment attachment or any other remedies on PDVSA's U.S. assets such as its shares in PDV Holding.[13] Conversely, PDVSA has taken no action to challenge the arbitral award, and the deadline for PDVSA to seek to vacate, modify or correct the arbitral award passed in late July.[14]

Additionally, within a matter of months, it is expected that ConocoPhillips will receive an award in its dispute with the Republic before ICSID. In that proceeding, the Republic has already been found liable, but the award quantifying ConocoPhillips's damages has yet to be issued. This could create another multi-billion dollar headache for the Republic and, by extension, for PDVSA and PDV Holding.

ii. Crystallex

In April 2016, Crystallex obtained a $1.1 billion ICSID arbitration award against the Republic of Venezuela for appropriating Crystallex's rights to the Las Cristinas gold mine.[15] Even before obtaining the award, Crystallex brought an action in Delaware federal court against PDVSA under the Delaware Uniform Fraudulent Transfer Act ("DUFTA").[16] The suit challenged a series of 2015 dividend payments from CITGO Holding to PDVSA by way of PDV Holding. The net effect of these transactions was to transfer roughly $3 billion from the U.S. to Venezuela—outside the reach of creditors like Crystallex and ConocoPhillips seeking to enforce their claims against assets in the U.S. In a separate action, Crystallex also challenged PDV Holding's pledges of CITGO Holding stock to the 2020 Bondholders and Rosneft, which it argued was intended to prevent judgment creditors from attempting to satisfy their judgments by

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[11] Ex. A (Final Award), *Phillips Petroleum Co. Venez., Ltd. v. Petróleos de Venez.*, No. 18 Civ. 3716 (S.D.N.Y. Apr. 24, 2018), ECF No. 8-1.

[12] ConocoPhillips also filed an enforcement action in the Netherlands Antilles, where a PDVSA affiliate has facilities for processing and storing oil for export.

[13] This may suggest that the oil project agreements that underlie the ConocoPhillips dispute lack waivers of sovereign immunity broad enough to include pre-judgment attachments. *See* 28 U.S.C. § 1609(d) (requiring explicit waiver of immunity from attachment prior to judgment).

[14] *See* 9 U.S.C. § 12.

[15] Crystallex subsequently brought an action in the District of Columbia to confirm this award in April 2016, which resulted in a March 2017 $1.4 billion judgment (including post-award, pre-judgment interest). In June 2017, the District Court of the District of Columbia issued an order finding that sufficient time for voluntary satisfaction of the judgment had passed. *See Crystallex Int'l Corp. v. Bolivarian Republic of Venez.*, No. 16 Civ. 0661 (RC) (D.D.C. June 9, 2017), ECF No. 39.

[16] Broadly speaking, DUFTA provides remedies for transfers made with actual fraudulent intent. Specifically, it requires a plaintiff to "successfully plead three things: (1) a transfer, (2) by a debtor, (3) with actual intent to hinder, delay or defraud a creditor." *See Crystallex Int'l Corp. v. Petróleos de Venez., S.A.*, 879 F.3d 79, 84 (3d Cir. 2018); Del. Code Ann. tit. 6, §§ 1301-1312 (West 2017).

foreclosing on PDV Holding's shares in CITGO. After obtaining a U.S. court judgment recognizing its arbitral award, Crystallex brought a third proceeding in Delaware federal court to enforce its judgment against the Republic by attaching the assets of PDVSA on the ground that PDVSA is the alter ego of the Republic.

In January 2018, the United States Court of Appeals for the Third Circuit ruled that PDV Holding was a non-debtor transferor, *i.e.*, not indebted to Crystallex, and therefore could not be liable under DUFTA.[17] While this presents a roadblock for Crystallex with respect to its DUFTA claims, it nonetheless leaves open the ability to pursue a DUFTA claim against PDVSA *if* Crystallex can demonstrate that PDVSA is an "alter ego" of the Republic. Such a finding could permit Crystallex to enforce its judgment against PDVSA's assets in the U.S.—namely its shares in PDV Holding, which would allow Crystallex to control CITGO, subject to the pledges and other transactions Crystallex is also challenging under DUFTA. The district court initially indicated that it would resolve any pending motions with regard to the alter ego question by June 30, 2018 but recently extended its anticipated ruling date to August 10, 2018.[18] The district court's revised schedule further reduces PDVSA's time to determine, in the wake of the court's forthcoming decision, whether to make the $840 million payment to the 2020 Bondholders and/or to initiate a PDV Holding bankruptcy in order to stay the effects of such a non-payment.[19]

iii. 2020 Bondholders

As mentioned above, in October 2016, PDVSA issued $3.4 billion in 2020 Bonds as part of an exchange offer. At issuance, PDV Holding granted a pledge of 50.1% of its shares of CITGO Holding to secure these bonds. PDVSA has continued to make interest payments to 2020 Bondholders, while strategically defaulting on most of its other bonds. However, many believe that a default is likely, either because (1) PDVSA will make the affirmative decision to miss the $840 million amortization payment that is due in October 2018 either strategically or because it does not have the cash on hand or (2) ConocoPhillips will successfully confirm its $2 billion arbitral award. Under the terms of the 2020 Bonds' indenture, either of these events

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[17] *Crystallex Int'l Corp.*, 879 F.3d at 87; *see also* Richard J. Cooper & Boaz S. Morag, *Third Circuit Dismisses Crystallex's Fraudulent Transfer Claim But Potential Liability Remains for PDVSA* (Jan. 5, 2018), https://www.clearygottlieb.com/~/media/files/third-circuit-dismisses-crystallexs-fraudulent-transfer-claim--cooper--morag-crystallex-dufta-3d-cir-article-1-5-2018.pdf.

[18] Notice, *Crystallex Int'l Corp. v. Bolivarian Republic of Venez.*, No. 17-mc-00151 (LPS) (D. Del. June 27, 2018), ECF No. 62. Interestingly, on July 30, 2018, the district court issued an order directing the parties to file supplemental briefing in respect of nine questions identified by the court—which range from questions on subject matter jurisdiction to whether Crystallex has or intends to request a license from OFAC—and advised the parties they should come to the August 3 oral argument prepared to address five additional questions, including whether a Crystallex victory would mean that "PDVSA is liable (formally or at least effectively) for all of Venezuela's debts, in all cases in which judgments have been registered in U.S. courts against Venezuela." Memorandum Order, *Crystallex Int'l Corp. v. Bolivarian Republic of Venez.*, No. 17-mc-00151 (LPS) (D. Del. July 30, 2018), ECF No. 68. This suggests that the district court's August 10 anticipated ruling date may be extended further.

[19] While Crystallex and ConocoPhillips may be the judgment creditors closest to obtaining court permission to pursue remedies against PDVSA and PDV Holding, there are several other ICSID and treaty claimants with an additional $2.2 billion in arbitral or court judgments close behind. *See supra* at note 6. If Crystallex can successfully demonstrate that (i) PDVSA is an alter ego of the Republic and (ii) that PDVSA is not shielded by sovereign immunity, any of these creditors may attempt to capitalize on their victory by asserting their claims against PDVSA using the same avenues discussed herein.

alone would constitute an event of default. If PDVSA fails to make the amortization payment, a default would be automatic. By contrast, if ConocoPhillips obtains a judgment on its arbitral award, the 2020 Bondholders would first need to send PDVSA a notice of default and demand for payment, which would give PDVSA 60 days to cure. If a default occurs and any applicable grace period expires, the 2020 Bondholders could then seek to foreclose on PDV's pledge of CITGO Holding shares. If PDVSA defaults on the 2020 Bonds, PDVSA may decide to authorize and direct PDV Holding to file for bankruptcy in order to forestall any effort to act on the CITGO Holding stock pledge.

iv. Rosneft

Another critical actor in a potential PDV Holding bankruptcy filing is likely to be Rosneft, the Russian state-controlled oil and gas company. In November 2016, Rosneft entered into a loan agreement with PDVSA, as part of which it received a pledge from PDV Holding of 49.9% of its CITGO Holding shares—the amount not already pledged to the 2020 Bondholders. Although the arrangements between Rosneft and PDVSA are not public, the assumption of most market participants is that Rosneft benefits from a pledge of CITGO Holding shares that, from a legal perspective, is similar to that of the 2020 Bondholders. What role and interests Rosneft would have in a PDV Holding bankruptcy is of course difficult to anticipate.

v. CITGO Holding and CITGO creditors

CITGO Holding and CITGO have a significant debt burden of their own, with nearly $5 billion in combined outstanding debt. The documents governing certain of this debt contain cross-default provisions that would be triggered by, among other things, a PDV Holding bankruptcy (as CITGO Holding's parent) as well as a change in control of either CITGO Holding or PDV Holding, whether through a voluntary sale or through a foreclosure or execution of a judgment. In order to address the consequences of these cross-defaults—and perhaps to bolster the strength of certain legal arguments discussed below—it is highly possible that the "PDV Holding bankruptcy" discussed in this article would involve a bankruptcy filing not only by PDV Holding, but also by its direct and indirect subsidiaries, including CITGO Holding and CITGO.

vi. PDVSA and Republic Creditors

In addition to direct creditors of the debtors, any PDV Holding bankruptcy will surely attract the interest and attention of PDVSA's and the Republic's creditors, whether they hold bond, bank, vendor, expropriation or other claims.

c. The U.S. Government

Finally, it goes without saying that we would expect the U.S. government, and more specifically the U.S. Treasury Department, to be keenly interested in any PDV Holding bankruptcy and any potential disposition of CITGO, directly or indirectly.[20]

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[20] A PDV Holding bankruptcy, and any proposed distributions made in connection with the proceeding, would be closely reviewed by the Office of Foreign Asset Control ("OFAC"), the agency within the Treasury Department that administers and enforces U.S. economic sanctions. *See infra* at 17. Furthermore, to the extent that a PDV Holding bankruptcy would result in a foreign entity gaining an equity interest in PDV Holding, CITGO Holding or CITGO, the granting of that equity may require a review by the Committee on Foreign Investment in the United States

II. A PDV Holding Bankruptcy: Possible Key Creditor and Debtor Actions

As briefly discussed above, this article presupposes a PDV Holding bankruptcy filing, which would include all of PDV Holding's direct and indirect subsidiaries, and which would likely be filed within days or weeks of the earlier of (a) PDVSA missing the October 2018 amortization payment due to the 2020 Bondholders (but prior to the expiration of any applicable grace period), (b) entry of a final judgment confirming ConocoPhillips's arbitral award or (c) Crystallex obtaining an order entitling it to execute on PDV Holding's shares. While the landscape is difficult to map comprehensively, below we discuss a number of potential scenarios, each focused on the reaction of a particular creditor constituency to such a filing, including the actions they may take and the legal and practical issues that may arise as a result. Because different courts evaluate the legal issues underlying these scenarios differently—sometimes materially so—the district in which PDV Holding files for bankruptcy is likely to have a material impact on the success of any attempt to have the filing dismissed. An obvious choice is the United States Bankruptcy Court for the District of Delaware—a popular bankruptcy forum and PDV Holding's state of incorporation. However, for strategic reasons discussed below, PDV Holding may likely seek to file elsewhere, particularly in the Southern District of New York. Thus, this article's analysis centers on the law in the Second Circuit, which includes New York, and the Third Circuit, which includes Delaware.

Our analysis focuses on three sets of scenarios within that framework. We begin with possible efforts the 2020 Bondholders may make to dismiss or otherwise avoid the effects of a PDV Holding bankruptcy, including through requests to dismiss the bankruptcy on the bases of bad faith or the doctrine of abstention, or a request for relief from the Bankruptcy Code's automatic stay to permit collateral foreclosure actions. Next, we address ways the 2020 Bondholders might attempt to extract value through a PDV Holding bankruptcy to the extent they are unable to escape it altogether.[21] We next examine how Crystallex, ConocoPhillips or other Republic and PDVSA creditors may attempt to turn a PDV Holding bankruptcy to their advantage in their ongoing battles to collect on their debts. Finally, we briefly discuss how the Republic, PDVSA or PDV Holding claimants might attempt to prevent a sale of CITGO Holding under Section 363 of the Bankruptcy Code.

a. "Fight the Filing": Attempts to Avoid the Bankruptcy Altogether

Although PDV Holding almost certainly meets the statutory requirements for Chapter 11 eligibility, the 2020 Bondholders may attempt to employ a variety of tools available to creditors seeking to stop an obligor from taking advantage of the Bankruptcy Code's protections. The most common method of defeating a Chapter 11 filing altogether is moving to dismiss the proceedings, either on the grounds that the filing is a "bad faith" filing, or under the abstention provisions of the Bankruptcy Code. The 2020 Bondholders might also take a less drastic approach and seek an order lifting the Bankruptcy Code's automatic stay in order to allow them to foreclose on the CITGO Holding stock pledge.

("CFIUS"), an Executive Branch body that reviews the national security implications associated with foreign investments in U.S. companies.

[21] While comparatively little is known about the details of the Rosneft transaction and the terms on which Rosneft may be able to enforce PDV Holding's pledge of 49.9% of its CITGO Holding shares, Rosneft may also seek to avail itself of the remedies discussed below in respect of the 2020 Bondholders. Unlike the bondholders, however, Rosneft would also have the additional hurdle of CFIUS review. *See supra* at n.19.

i. Bad Faith Filing Objection

The Bankruptcy Code permits a bankruptcy court to dismiss a bankruptcy petition "for cause" where doing so "is in the best interests of creditors and the [debtor's] estate."[22] Although cause is not defined in the Bankruptcy Code, it is well established that a finding of "bad faith" by the debtor justifies dismissal.[23] However, what exactly constitutes sufficient "bad faith," and the metrics that various courts use to evaluate it, differs significantly among the circuits.[24]

Generally speaking, courts in the Second and Third Circuits evaluate both "objective" and "subjective" bad faith in adjudicating a motion to dismiss. "Objective" bad faith typically refers to "facts that evidence the debtor's inability to reorganize as an economically viable going concern."[25] In assessing "the objective futility of the reorganization process," courts employ a variety of factors, including the nature and extent of the debtor's assets and liabilities, the extent of a debtor's business operations and whether the court believes there is a "reasonable probability that a reorganization plan can be proposed and confirmed."[26] By contrast, "subjective" bad faith focuses on the conduct of the putative debtor and seeks to ensure that the debtor "actually intends 'to use the provisions of Chapter 11 . . . to reorganize or rehabilitate an existing enterprise'"[27] as opposed to "simply to cause hardship or to delay its creditors."[28] Courts look at several metrics to evaluate subjective bad faith, including whether the bankruptcy was filed on the eve of a foreclosure, whether the proceeding is essentially a "two-party dispute" between the debtor and a single creditor, or whether the bankruptcy was otherwise filed for the purpose of creating an automatic stay.[29]

Despite the fact that courts in both the Second and Third Circuits analyze broadly similar factors when asked to dismiss a bankruptcy for "bad faith," there are key differences in their approaches. First, in the Second Circuit, the party seeking dismissal generally has the burden of demonstrating that "from the date of filing, the debtor has no reasonable probability of emerging from the bankruptcy proceeding and no realistic chance of reorganization."[30] The reverse is typically true in the Third Circuit, where "the burden is on the bankruptcy petitioner to establish [good faith]."[31] Second, and perhaps most critically, whereas courts in the Third Circuit will dismiss a bankruptcy filing upon a finding of *either* objective or subjective bad

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[22] 11 U.S.C. § 1112(b)(1) (2016).

[23] *See, e.g.*, *In re SGL Carbon Corp.*, 200 F.3d 154, 160 (3d Cir. 1999).

[24] *See, e.g.*, *id.* at 162; *In re RCM Glob. Long Term Capital Appreciation Fund, Ltd.*, 200 B.R. 514, 520 (Bankr. S.D.N.Y. 1996) (requiring both subjective and objective bad faith).

[25] *Id.*

[26] *In re RCM*, 200 B.R. at 520; *Adirondack Mines, Inc. v. U.S. Tr.*, No. 10 Civ. 411 (GLS), 2010 U.S. Dist. LEXIS 12209, at *5 (N.D.N.Y. Nov. 16, 2010); *see also In re SGL Carbon Corp.*, 200 F.3d at 160.

[27] *In re E. End Dev., LLC*, 491 B.R. 633, 642 (Bankr. E.D.N.Y. 2013).

[28] *In re RCM*, 200 B.R. at 522; *see also In re 15375 Mem'l Corp. v. Bepco, L.P.*, 589 F.3d 605, 618 (3d Cir. 2009) (subjective bad faith assesses, among other things, whether "the petition is filed merely to obtain a tactical litigation advantage").

[29] *See, e.g.*, *In re JER/Jameson Mezz Borrower II, LLC*, 461 B.R. 293, 298–99 (Bankr. D. Del. 2011); *Adirondack Mines, Inc.*, 2010 U.S. Dist. LEXIS 12209, at *5 (N.D.N.Y. Nov. 16, 2010).

[30] *C-TC 9th Ave P'Ship v. Norton Co.*, 113 F.3d 1304, 1310 (2d Cir. 1997).

[31] *In re 15375 Mem'l Corp. v. Bepco, L.P.*, 589 F.3d 605, 618 (3d Cir. 2009).

faith,[32] courts in the Second Circuit will dismiss a petition only "if *both* objective futility of the reorganization process *and* subjective bad faith in filing the petition are found."[33] This additional requirement, when combined with placing the burden on the moving party to demonstrate bad faith, proves in many cases to be outcome determinative. Indeed, where a movant fails to demonstrate the objective futility of a bankruptcy filing, courts in the Southern District of New York will generally allow the proceeding to go forward even where it is undisputed that the debtor acted in subjective bad faith to frustrate a creditor's ability to foreclose on the debtor's assets.[34]

It is all but certain that the 2020 Bondholders would allege that PDV Holding's bankruptcy is simply an attempt to frustrate the 2020 Bondholders' rights *vis-à-vis* the CITGO Holding pledge. The success of such an argument could depend in part on the timing of a PDV Holding filing. Specifically, such a filing may come in anticipation of or close on the heels of both the 2020 Bondholders' attempts to foreclose on the CITGO Holding shares and a possible adverse ruling in the Crystallex or ConocoPhillips disputes. If two or more groups of creditors were pursuing PDV Holding, it would be more difficult to prevail under the lines of cases that find bad faith where a court determines the debtor's bankruptcy is essentially a "two-party dispute" with a single creditor. In addition, if PDV Holding makes the decision to file in the Southern District of New York, where a bad faith filer may nonetheless continue with the bankruptcy process where it "has a potentially viable business in place to protect and rehabilitate,"[35] it may be able to effectively argue that, whatever its motives, a PDV Holding bankruptcy will lead to a healthier, less indebted corporate family, particularly with respect to CITGO.[36] In the Third Circuit, by contrast, PDV Holding may have a much more difficult road in arguing that its filing should not be seen as a bad faith attempt to gain an advantage over the 2020 Bondholders in their fight for control over CITGO Holding. If the 2020 Bondholders were successful in that regard, the objective feasibility of a PDV Holding bankruptcy may not be enough to survive a motion to dismiss.

To the extent PDV Holding seeks to avail itself of the more favorable bad faith case law in the Second Circuit, the 2020 Bondholders could ask the bankruptcy court to transfer the case to the District of Delaware (which is bound by the more creditor-friendly bad faith standard in the Third Circuit). Generally speaking, in order to establish venue in the Southern District of New York, PDV Holding would need to demonstrate that the district has been the location of its "domicile, residence, principal place of business . . . or principal assets" for at least

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[32] *See, e.g., In re JER/Jameson Mezz Borrower II, LLC,* 461 B.R. at 298.

[33] *In re RCM,* 200 B.R. at 520.

[34] *See In re Kingston Square Assocs.*, 214 B.R. 713 (Bankr. S.D.N.Y. 1997).

[35] *In re RCM,* 200 B.R. at 520.

[36] Notably, this would require a bankruptcy court to assess PDV Holding's prospects for reorganization together with its subsidiaries. While the 2020 Bondholders may argue that PDV Holding, which appears to have no debt or very little debt, does not need to reorganize, some courts have found that "the interests of the [corporate] group can and should be considered." *In re Gen. Growth Properties, Inc*., 409 B.R. 43, 61 (Bankr. S.D.N.Y. 2009). Further, the 2020 Bondholders may also argue that there can be no effective reorganization of PDV Holding because existing U.S. policy would prohibit the issuance of reorganized equity or other value to PDVSA in its capacity as the sole holder of PDV Holding equity.

91 days before any bankruptcy filing.[37] For companies whose headquarters and operations are located out-of-district, establishing venue can be challenging. The same could be said for PDV Holding, an entity domiciled in Delaware with no principal place of business. However, PDV Holding could seek to incorporate a new entity under the laws of New York, or even open a New York bank account to hold its liquid assets. Manufacturing venue in this way, while legally permissible and sufficient to meet the statutory requirements, is not without its risks.

For example, in *In re Patriot Coal Corp.*, shortly before filing their Chapter 11 cases in the Southern District of New York, the debtors—whose headquarters and operations were largely in Missouri and West Virginia—incorporated a new New York subsidiary.[38] Once incorporated, the subsidiary moved its sole asset, a certificate evidencing its ownership of a coal company, to the Manhattan office of its lender's counsel.[39] Shortly after filing, a group of creditors and unions filed a motion to transfer venue to West Virginia.[40] In its decision on the motion, the bankruptcy court determined that the debtors had created the new subsidiary for the sole purpose of establishing venue in New York, but had not acted in bad faith.[41] Nonetheless, the bankruptcy court transferred venue in the "interests of justice."[42] If PDV Holding attempts to follow in the footsteps of the *Patriot Coal* debtors, it is likely the 2020 Bondholders would make a similar motion to transfer. Unlike in *Patriot Coal*, however, PDV Holding may be able to argue that the 2020 Bondholders are not interested in moving the bankruptcy to the "home" of PDV Holding or even a bankruptcy court with greater familiarity with its operations or stakeholders, but instead are engaging in "reverse forum shopping" by attempting to move their dispute to a venue with more favorable law.

ii. Request for Abstention

Rather than launching an attack on PDV Holding's "bad faith," or perhaps packaged with it, the 2020 Bondholders could predicate their request for dismissal on the interests of the parties involved through a request for abstention under Section 305 of the Bankruptcy Code. Like a motion for dismissal of a "bad faith" filing, a request for abstention seeks to dismiss a bankruptcy petition in its entirety. Abstention is appropriate where the bankruptcy court finds that "the interests of creditors and the debtors would be better served by such dismissal or suspension. . . ."[43] While the tests employed by the Third and Second Circuits differ in some respects, both circuits agree that abstention is an "extraordinary remedy."[44]

[37] 28 U.S.C. §1408. Once one debtor establishes venue in a district, its affiliates can establish venue on the basis that "[t]here is a bankruptcy case concerning [their] affiliate, general partner, or partnership pending" in the district. *See In re Patriot Coal Corp.*, 482 B.R. 718, 725 (Bankr. S.D.N.Y. 2012).

[38] *In re Patriot Coal Corp.*, 482 B.R. at 726.

[39] *Id.*

[40] *Id.*

[41] *Id.* at 741.

[42] *Id*. at 746. Interestingly, the bankruptcy court refused to transfer the proceeding to West Virginia and ultimately determined that a transfer to Missouri—where Patriot's headquarters were located—was in the interests of justice. *Id*.

[43] 11 U.S.C. § 305(a) (2016).

[44] *See In re Northshore Mainland Servs., Inc.*, 537 B.R. 192, 207 (Bankr. D. Del. 2015); *In re Aerovias Nacionales de Colombia S.A. Avianca*, 303 B.R. 1, 9 (Bankr. S.D.N.Y. 2003).

Courts in both the Second and Third Circuits focus on a variety of non-exhaustive factors when asked to abstain from a bankruptcy, including: (1) the economy and efficiency of administration, (2) whether another forum is available to protect the interests of both parties or there is already a pending proceeding in state court, (3) whether federal proceedings are necessary to reach a just and equitable solution, (4) whether there is an alternative means of achieving an equitable distribution of assets, (5) whether the debtor and creditors are able to work out a less expensive out-of-court arrangement which better serves all interests in the case, (6) whether a nonfederal insolvency has proceeded so far in those proceedings that it would be costly and time-consuming to start afresh with the federal bankruptcy process, and (7) the purpose for which bankruptcy jurisdiction has been sought.[45]

Because a decision to abstain is left to the discretion of the individual judge, it is difficult to assess with any particularity which factor or factors may influence a decision in a PDV Holding bankruptcy, let alone how those factors would be weighed against each other. On the one hand, abstention would provide the 2020 Bondholders direct access to PDV Holding's most valuable asset—its shares of CITGO Holding—which would allow for an efficient administration of PDV Holding's central liability. On the other hand, foreclosure would likely eliminate any chance that PDV Holding could reorganize. Indeed, other creditors may be incentivized to join PDV Holding in opposing abstention in order to avail themselves of the organized process and centralized forum that a bankruptcy would provide for resolving intercreditor disputes. Relatedly, it is uncertain how a bankruptcy court would interpret the fact that PDV Holding's debt largely springs from its Venezuelan parent and (as discussed below) perhaps the Republic itself. Some courts have found that abstention is proper where a wholly foreign entity seeks to take advantage of the U.S. bankruptcy regime.[46] However, PDV Holding, unlike PDVSA, may be able to rely on the fact that it is a U.S. incorporated entity with U.S.-based subsidiaries that operate a robust domestic business. In *In re Northshore Mainland Services*, for example, the bankruptcy court specifically refused to abstain from the bankruptcy case of a Delaware incorporated entity, even where it abstained from the cases of its Bahaman debtor-affiliates, reasoning that the Delaware entity's creditors "would expect [its] financial difficulties to be addressed in a proceeding in the United States."[47] As with the potential for a "bad faith" dismissal, abstention will largely depend on the specific facts of the bankruptcy filing and the ability of PDV Holding to effectively argue that it has a path to reorganization or other equitable distribution of its assets. However, the fact that PDV Holding is a Delaware corporation will weigh against abstention.

iii. Seeking Relief from Stay

Even if they are unsuccessful in seeking to dismiss PDV Holding's bankruptcy petition, the 2020 Bondholders may nonetheless seek permission to foreclose on the CITGO Holding shares by requesting relief from the Bankruptcy Code's automatic stay, which prevents parties from taking any action in respect of the assets of a debtor during the pendency of its bankruptcy. Unlike a motion to dismiss, a request for stay relief is narrowly tailored to the needs

[45] *In re Northshore Mainland Servs., Inc.*, 537 B.R. at 203; *In re Monitor Single Lift I, Ltd.*, 381 B.R. 455, 464-65 (Bankr. S.D.N.Y. 2008).

[46] *In re Stillwater Asset Backed Offshore Fund Ltd.*, 485 B.R. 498, 509 (Bankr. S.D.N.Y. 2013) (citing *GMAM Investment Funds Trust I v. Globo Comunicacoes e Participacoes S.A.*, 317 B.R. 235, 255–57 (S.D.N.Y. 2004)).

[47] *See In re Northshore Mainland Servs., Inc.*, 537 B.R. at 207.

of a specific creditor—here, a request that the bankruptcy court permit the 2020 Bondholders to exercise their rights under the CITGO Holding pledge. Relief from the automatic stay is granted "for cause."[48] The Bankruptcy Code does not explain with any particularity what constitutes sufficient "cause," but most courts agree it is intended to be a flexible standard that permits the bankruptcy court to respond to a wide range of factual circumstances.[49]

As the "flexible standard" moniker suggests, courts consider a range of factors, including the policies reflected in the Bankruptcy Code, the interests of the debtor, other creditors and any other interested parties.[50] Within the Second Circuit, these factors also include, among many: (1) whether relief would result in a partial or complete resolution of the issues, (2) the lack of any connection with or interference with the bankruptcy case, (3) whether the action primarily involves third parties, (4) the interests of judicial economy and the expeditious and economical resolution of litigation and (5) the impact of the stay on the parties and the balance of harms.[51] Not all factors will be relevant in a given case,[52] and courts do not need to weigh each factor equally.[53] Similarly, courts in the Third Circuit typically consider three factors: (1) the prejudice that would be suffered [by the debtor] should the stay be lifted, (2) the balance of the hardships facing the parties and (3) the probable success on the merits if the stay is lifted.[54]

Similar to the arguments made in respect of abstention, if the 2020 Bondholders seek permission to foreclose on the CITGO Holding pledge, PDV Holding may be able to argue that its CITGO Holding shares are essential to its prospects for reorganization, particularly where CITGO continues to generate operating revenue, and that lifting the stay would therefore cause extreme prejudice to PDV Holding.[55] This argument would likely depend, at least in part, on PDV Holding's ability to argue that a 49.9% stake in CITGO Holding—the amount that would be left after the 2020 Bondholders potentially collected on their pledge—would be insufficient to support an effective restructuring.[56] Other creditors may join PDV Holding in opposing a motion to lift the automatic stay based on the same process and centralized forum advantages that could motivate them to oppose a motion for abstention. By contrast, because the 2020

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[48] 11 U.S.C. § 362(d).

[49] *In re Senty Park, Ltd.*, 87 B.R. 427, 430 (Bankr. W.D. Tex. 1988).

[50] *In re Chatkin*, 465 B.R. 54, 60 (Bankr. W.D. Pa. 2012) (quoting *In re Chan*, 355 B.R. 494, 499 (Bankr. E.D. Pa. 2006)).

[51] *In re Sonnax Indus., Inc.*, 907 F.2d 1280, 1286 (2d Cir. 1990) (listing twelve non-exhaustive factors relevant to requests to lift the Bankruptcy Code's automatic stay).

[52] *See Mazzeo v. Lenhart*, 167 F.3d 139, 143 (2d Cir. 1999).

[53] *See Lamarche v. Miles*, 416 B.R. 53, 58 (E.D.N.Y. 2009) (citing *Burger Boys, Inc. v. S. St. Seaport Ltd. P'ship*, 183 B.R. 682, 688 (S.D.N.Y. 1994)).

[54] *In re Cont'l Airlines, Inc.*, 152 B.R. 420, 424 (Bankr. D. Del. 1993); *see also In re Olayer*, 577 B.R. 464, 471 (Bankr. W.D. Pa. 2017).

[55] *Matter of Newark Airport/Hotel Ltd. P'ship*, 156 B.R. 444, 450 (Bankr. D.N.J.), *aff'd sub nom. FGH Realty Credit Corp. v Newark Airport/Hotel Ltd. P'ship*, 155 B.R. 93 (D.N.J. 1993) (refusing to lift the automatic stay to permit foreclosure on a debtor's single asset because, *inter alia*, the asset "is necessary for an effective reorganization"); *see also Borman v. Raymark Indus., Inc.*, 946 F.2d 1031, 1036 (3d Cir. 1991) (the automatic stay was designed, in part, "to prevent certain creditors from gaining a preference for their claims against the debtor").

[56] This argument, of course, assumes that Rosneft would be unwilling or unable to exercise its right to the remaining 49.9% of CITGO Holding shares as part of a PDV Holding bankruptcy.

Bondholders enjoy the privileged position of secured creditors, who are entitled to have their claims paid in full up to the value of their underlying security interests,[57] they may have a more difficult time arguing that they would face hardship if PDV Holding were afforded an opportunity to attempt a reorganization, particularly if PDV Holding can demonstrate that such an attempt would not affect the value of the 2020 Bondholders' collateral and if the 2020 bondholders are provided adequate protection.[58] The unique factual circumstances of a PDV Holding bankruptcy would ultimately drive any bankruptcy court's analysis, but whatever those circumstances are, demonstrating the "cause" necessary to justify lifting the Bankruptcy Code's automatic stay, which has proven to be a high bar, undoubtedly will pose a challenge for the 2020 Bondholders. This will be particularly true in the early months of a PDV Holding bankruptcy, where courts are generally reluctant to grant material stay relief while the debtors focus on stabilizing their affairs and operations.

b. "Fighting Within the Filing": Extracting Financial Value During or Through a PDV Holding Bankruptcy

Avoiding the application of the Bankruptcy Code is not the only avenue available to the 2020 Bondholders in their quest to realize value from the PDV Holding pledge. Quite to the contrary, the 2020 Bondholders could participate in the potential PDV Holding bankruptcy as a secured creditor and, by exercising their rights as such, extract significant value. The most likely methods for doing so, explored further below, are a request for "adequate protection" during the course of the bankruptcy, or a request for payment of post-petition or "default" interest at the proceedings' conclusion.

i. Request for Adequate Protection Payments

The Bankruptcy Code requires debtors to provide secured creditors "adequate protection" against the diminution in value of their collateral that may occur during or as a result of a debtor's bankruptcy.[59] The Bankruptcy Code does not define "adequate protection," but Section 361 sets out three examples of what *may* constitute adequate protection: (1) payment of periodic cash payments; (2) an additional or replacement lien on the debtor's assets; or (3) other relief that provides the secured creditor with "the indubitable equivalent of [their] interest in [the secured collateral]."[60] Debtors who opt for periodic payments generally offer to make the interest payments that would otherwise be owed to a secured creditor along with reimbursement of the creditor's legal expenses incurred during the course of the bankruptcy. Additional or replacement liens often, but not always, involve granting liens on previously unencumbered collateral. The "indubitable equivalent" option is not well defined by courts; the jurisprudence on this option exists largely as a collection of opinions determining whether bespoke arrangements do or do not satisfy the amorphous concept, typically without any doctrinal framework that can be applied to future cases.[61] In addition to the examples in Section 361, it is

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[57] *See* 11 U.S.C. § 506(a).

[58] As discussed below, this analysis intersects with whether or not the 2020 Bondholders would be entitled to adequate protection against any decline in the value of the CITGO Holding shares during the pendency of a PDV Holding bankruptcy.

[59] *See, e.g., In re Residential Cap., LLC,* 501 B.R. 549, 589 (Bankr. S.D.N.Y. 2013).

[60] 11 U.S.C. § 361.

[61] *See generally* Ben Ellison, Brian Rooder, Keith Wofford & Steve Krause, *Recent Developments in Adequate Protection under Section 361*, 2017 Ann. Surv. of Bankr. Law 17, (Sept. 2017).

well established that, if the debtor can demonstrate that the value of the relevant collateral significantly exceeds the amount of the secured creditor's claim, this excess value or "equity cushion" may itself constitute adequate protection.[62]

Disputes regarding adequate protection typically begin, and often end, with a battle over the value of the relevant collateral. This is true with respect to the existence and size of an equity cushion as well as the predicate question of whether the collateral's value is at risk of declining in value. Where a secured creditor challenges whether it has received adequate protection, it is the creditor's burden to demonstrate the amount of its secured claim.[63] This necessarily requires evidence of the value of the underlying collateral (whatever the size of a secured creditor's claim against the debtor, it can only be "secured" up to the value of the underlying collateral).[64] Once established, the burden shifts to the debtor to establish that it has provided the secured creditor adequate protection against the potential for diminution in value of the secured creditor's collateral. Both parties' arguments typically require nuanced analysis by financial advisors or other experts.

Depending on the particular circumstances, valuation can be more complex when, as in a PDV Holding bankruptcy, the collateral at issue is an intangible asset like stock. If the stock is publicly traded, it may be relatively straightforward to assess its value (*i.e.*, the company's market cap) as well as whether the "stock is of such a volatile nature" to require a debtor to provide adequate protection against a potential drop in value.[65] Of course, if a company is privately owned, no market price exists for its stock. In that scenario, a court will conduct a more holistic analysis of a company's enterprise value, including whether its financial condition has deteriorated or otherwise changed so as to affect the value of its stock.[66]

Because CITGO Holding is not a public company, both PDV Holding and the 2020 Bondholders would rely on expert analysis to establish the value of the company and therefore its stock. PDV Holding is likely to take the position that the value of CITGO Holding, as an enterprise, significantly exceeds the $2.5 billion currently owed to the 2020 Bondholders. Notably, in 2014, the Republic briefly entertained the idea of selling CITGO and reportedly received bids in excess of $10 billion.[67] If PDV Holding can demonstrate that CITGO Holding would fetch a similar price if sold today, it would create a substantial equity cushion—even accounting for Rosneft's 49.9% pledge and the interest that would accrue during the pendency of a bankruptcy proceeding. As courts generally find that a 20% or more equity cushion provides

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[62] *See, e.g.*, *In re AMR Corp.*, 490 B.R. 470, 478 (S.D.N.Y. 2013); *In re JER/Jameson Mezz. Borrower II, LLC*, 461 B.R. at 305-06.

[63] *See, e.g.*, *In re Heritage Highgate, Inc.*, 679 F.3d 132, 140 (3d Cir. 2012); *In re Sneijder*, 407 B.R. 46, 55 (Bankr. S.D.N.Y. 2009).

[64] *Id.*

[65] *In re Whitney*, Case No. 4-88-3885, 1988 WL 141523, at *4 (Bankr. D. Minn. Dec. 20, 1988).

[66] *See, e.g.*, *In re Domestic Fuel Corp.*, 70 B.R. 455, 458, 463 (Bankr. S.D.N.Y. 1987) (finding that a company's declining financial condition "resulted in a consequential decline in the value of their stock which was pledged by the debtor").

[67] Mike Stone & Jessica Resnick-Ault, *Citgo Valued at More than $10 Billion in Revised Bids*, Reuters, Dec. 16, 2014, https://www.reuters.com/article/us-citgo-m-a-bids/exclusive-citgo-valued-at-more-than-10-billion-in-revised-bids-sources-idUSKBN0JU2DF20141216.

adequate protection,[68] this would make it exceedingly difficult for the 2020 Bondholders to demonstrate that they need additional adequate protection.[69] If the 2020 Bondholders can successfully argue that CITGO Holding's value is susceptible to decline below the amount of their claim, they should be able to extract significant adequate protection payments and obligations from PDV Holding. Because PDV Holding itself appears to have *de minimis* assets to offer as replacement collateral, the most likely option would be payment of the semi-annual payments due to 2020 Bondholders together with their legal expenses incurred in the course of the proceeding.

ii. Payment of Postpetition Interest

An adverse ruling on adequate protection would not necessarily be the final word on the ability of the 2020 Bondholders to receive the payments due under the 2020 Bonds' indenture. In fact, depending on the basis for the bankruptcy court's decision on adequate protection, an adverse ruling may actually lay the groundwork for the argument that 2020 Bondholders are entitled to receive the substantial interest and amortization payments that will have accrued during the pendency of the PDV Holding bankruptcy. Unlike adequate protection payments, which provide value to secured creditors during the pendency of a bankruptcy proceeding, the payment of accrued interest occurs at the conclusion of a debtor's bankruptcy. A secured creditor's entitlement to postpetition interest (or the rate at which such interest is calculated) is often disputed and, in all likelihood, a PDV Holding bankruptcy would be no different.

As a general matter, "interest stops accruing at the date of [a debtor's bankruptcy filing]" because the Bankruptcy Code largely prohibits claims for unmatured interest, *i.e.*, interest that had not yet come due on the date of the bankruptcy filing.[70] The Bankruptcy Code contains an important exception to this general rule for secured creditors where the value of their collateral, as determined by the bankruptcy court, "is greater than the amount of [their] claim."[71] This means that, whereas a creditor seeking adequate protection is incentivized to argue it is only minimally secured—in order to prevent an argument that it is protected by a substantial equity cushion—they must demonstrate the exact opposite to secure claims for postpetition interest.[72] Thus, while the methods employed to assess the value of the 2020 Bondholders' security interest in the CITGO Holding stock will likely mirror those used in an adequate protection dispute, the positions of the parties would need to reverse. As a result, both PDV Holding and the 2020 Bondholders would need to carefully consider the likelihood of success on the merits of an adequate protection dispute because, absent an intervening change in the value of CITGO

[68] *See In re James River Assocs.*, 148 B.R. 790, 796 (E.D. Va. 1992) ("Case law has almost uniformly held that an equity cushion of 20% or more constitutes adequate protection . . . ."); *Heritage Sav. & Loan Ass'n v. Rogers Dev. Corp. (In re Rogers Dev. Corp.)*, 2 B.R. 679, 685 (Bankr. E.D. Va. 1980) (approximately 15% to 20% was sufficient adequate protection to the creditor).

[69] It should be noted that some courts have found that, based on an individualized analysis of the specific risks to the collateral at issue, the existence of an equity cushion is insufficient, by itself, to provide a secured creditor adequate protection. *LNC Inv. Inc. v. First Fidelity Bank*, 1997 WL 528283, at *5 (S.D.N.Y. Aug. 27, 1997).

[70] H.R. Rep. No. 595, 9th Cong., 1st Sess. 352-54 (1977); 11 U.S.C. § 502(b)(2).

[71] 11 U.S.C. § 506(b).

[72] *See, e.g.*, *In re Saypol*, 31 B.R. 796, 800 (Bankr. S.D.N.Y. 1983) (observing that the Bankruptcy Code "allows interest only to the extent that the value of the creditor's interest exceeds the claim").

Holding, the bankruptcy court's findings on valuation would likely be outcome determinative in a later postpetition interest battle.

c. Openings for Crystallex and ConocoPhillips

As this article has explored, the 2020 Bondholders will be a key participant in any PDV Holding bankruptcy proceeding. But they are not the only ones. A PDV Holding bankruptcy would also provide unique opportunities for creditors of the Republic and PDVSA, most notably ConocoPhillips and Crystallex, to collect on their outstanding debts. Furthermore, as bearers of anticipated and already obtained U.S. court judgments against the Republic and PDVSA, creditors like ConocoPhillips and Crystallex could use their judgments to turn a PDV Holding bankruptcy decidedly in their favor.[73]

Currently, although neither of ConocoPhillips or Crystallex have contract-based claims against PDV Holding, their pending U.S. court actions should be sufficient to grant them standing to participate in a PDV Holding bankruptcy.[74] Furthermore, Crystallex's pending legal action in Delaware may also provide an opening not only to enter PDV Holding's bankruptcy, but in fact to do so as PDV Holding's owner. In order to achieve that, Crystallex would need to achieve a series of successes in its pending Delaware action.

First, Crystallex would need to prevail on its claim that PDVSA is an alter ego of the Republic such that its assets are subject to seizure to satisfy the judgment against the Republic. As noted above, a decision on that issue is expected on or near August 10, 2018.[75] Second, Crystallex would need to succeed in arguing that PDVSA's shares in PDV Holding are being "used for a commercial activity," one of the statutory exemptions to the FSIA's grant of sovereign immunity.[76] If Crystallex is successful on both fronts, Crystallex could seek to enforce its judgment against the Republic by attaching and executing on PDVSA's shares of PDV Holding, though it is important to note that, given the existence of U.S. sanctions, Crystallex may need to receive a license from OFAC permitting the execution.[77] PDVSA could argue that the

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[73] While Crystallex or ConocoPhillips might have incentives to pursue an involuntary bankruptcy filing against PDV Holding—largely to prevent PDVSA from attempting to drain PDV Holding of value prior to an execution on its shares—either would likely have a difficult time establishing that, among other requirements, there existed "three or more entities" whose claims were "not contingent as to liability or the subject of a bona fide dispute as to liability or amount," particularly given the likelihood for an appeal by PDVSA in the event of an adverse ruling in either the Crystallex or ConocoPhillips proceedings. *See* 11 U.S.C. § 303.

[74] *See, e.g.*, 11 U.S.C. §1109(b) ("A party in interest, including the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee, may raise and may appear and be heard on any issue in a case under this chapter"); *In re Kressler*, No. 99-22646, 2001 WL 919860, at *2 (E.D. Pa. Aug. 9, 2001), *aff'd*, 40 F. App'x 712 (3d Cir. 2002) (a party in interest includes anyone "whose pecuniary interest is directly affected by the bankruptcy proceeding, that is, one who has an interest in the res to be administered and distributed") (internal quotations omitted); *see also Unofficial Comm. of Zero Coupon Noteholders v. Grand Union Co.*, 179 B.R. 56, 58–59 (D. Del. 1995) (granting standing to bondholders of a debtor's parent corporation who claimed the debtor's plan of reorganization would render the parent unable to meet its bond obligations).

[75] *Supra* at 3.

[76] 28 U.S.C. § 1605(a).

[77] In response to the district court's July 30 order, *see supra* at n. 17, Crystallex has taken the position that (i) as a Canadian corporation, it is not subject to U.S. sanctions law and execution on CITGO Holding shares would not require an OFAC license and (ii) its execution on the CITGO Holding shares is already covered by an existing license that permits transactions incident to a prior settlement agreement between Crystallex and Venezuela, which

value of PDV Holding exceeds the value of Crystallex's judgment and that, as a result, it should only be able to execute on a fraction of PDVSA's ownership of PDV Holding.[78] Finally, if Crystallex's alter ego arguments are successful, other Republic judgment creditors may be emboldened by that success to make similar alter ego claims in an attempt to satisfy their claims against PDVSA by foreclosing on its ownership interest in PDV Holding.[79]

Similarly, once its ICC Award against PDVSA is confirmed, ConocoPhillips could move to execute on PDVSA's assets, including its shares in PDV Holding. Although Crystallex's arbitral award was confirmed well before ConocoPhillips', ConocoPhillips does have a strategic advantage over Crystallex because its ICC Award is, and the judgment it is pursuing would be, against PDVSA itself, and not Venezuela. For this reason, ConocoPhillips' DUFTA and attachment actions against PDVSA do not require a finding that PDVSA is an alter ego of Venezuela. In fact, ConocoPhillips filed a DUFTA challenge to the PDVSA dividend payments in October 2016, well before its arbitration concluded or its award even issued.[80] Assuming that Crystallex, ConocoPhillips or another of the Republic's or PDVSA's judgment creditors successfully take control of PDV Holding, the entire course of its bankruptcy proceeding could change.

i. Taking Control of PDV Holding

In the event that Crystallex or ConocoPhillips is successful in executing on a judgment against PDVSA, their first priority is likely to be to take control of PDV Holding by replacing its existing board of directors and management. Ordinarily, the equity owner of a company is free to make appointments to the board of directors and, through the board, to direct the operations of the company. That said, the pendency of a PDV Holding bankruptcy may provide PDVSA and its designated existing PDV Holding board a path to challenge the ability of a new PDV Holding owner (such as Crystallex or ConocoPhillips) to control the company.

Section 362 of the Bankruptcy Code prevents any person from taking any action "to exercise control over the property of the estate" during the pendency of the bankruptcy.[81] The existing PDV Holding board may argue that a new owner's attempt to take control of the

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Crystallex contends "contemplates continued enforcement efforts" with respect to Crystallex's arbitral award. Letter, *Crystallex Int'l Corp. v. Bolivarian Republic of Venez.*, No. 17-mc-00151 (LPS) (D. Del. August 2, 2018), ECF No. 70. That said, Crystallex committed to seeking "clarification" from OFAC if the Court should deem it necessary. *Id.* For its part, PDVSA disputes that the existing license, which predates the most recent executive order on Venezuela-related sanctions, would permit execution on the CITGO Holding shares. Letter, *Crystallex Int'l Corp. v. Bolivarian Republic of Venez.*, No. 17-mc-00151 (LPS) (D. Del. August 2, 2018), ECF No. 71.

[78] Because PDV Holding's assets appear to begin and end with its CITGO Holding shares, a bankruptcy court's assessment of the value of CITGO Holding may be instructive. However, because this dispute would not play out in bankruptcy court, a decision by the Delaware court would likely not be determinative.

[79] It should be noted, however, that Crystallex's alter ego arguments rely on facts unique to their case which would not be available to other creditors seeking to follow in Crystallex's footsteps. *See generally* Opening Brief in Support of Plaintiff Crystallex International Corporation's Motion for an Order Authorizing the Issuance of a Writ of Attachment *Fieri Facias* Pursuant to 28 U.S.C. § 1610(c), *Crystallex Int'l Corp. v. Bolivarian Republic of Venez.*, No. 17-mc-00151 (D. Del.) (Aug. 14, 2017), ECF No. 3-1.

[80] Like the other Delaware federal court actions against PDVSA and related entities, this action has been stayed pending resolution of Crystallex's attachment action against PDVSA. *See ConocoPhillips Petrozuata B.V. v. Petróleos de Venezuela S.A.*, No. 16-cv-904 (D. Del. May 1, 2018), ECF No. 62.

[81] 11 U.S.C. § 362(a)(3)

day-to-day operations of PDV Holding, through the election of a new board of directors, is tantamount to exercising "control over the property of [PDV Holding's] estate" and therefore in violation of Section 362.

Although this application of Section 362 is somewhat uncommon, courts in the Third Circuit have confronted this precise question. In *In re Marvel Entertainment Group, Inc.*, a group of bondholders exercised their rights under a pledge agreement with the parent of debtor Marvel Entertainment to take control of the debtor's shares.[82] When the bondholders attempted to vote their pledged shares to replace the debtor's board of directors, the debtor sought and received an order from the bankruptcy court finding that the vote violated Section 362.[83] On appeal, the district court reversed, finding that the bondholders had properly obtained control by virtue of their status as creditors of the parent (and not as creditors of the debtor) and that, as a result, Section 362 was inapplicable.[84] The district court did note, however, that the outcome may have been different if the debtor had been able to demonstrate that the bondholders were exercising their ownership rights in order to enhance their position as creditors of the debtor.[85] The Second Circuit has similarly held in *In re Johns Manville* that the exercise of corporate governance rights in order to compel a shareholder's meeting to elect a new board of directors does not run afoul of Section 362 unless the debtor can show the shareholders "are guilty of clear abuse," which it defined as a "willingness to risk rehabilitation altogether in order to win a larger share for equity."[86]

Based on the framework set out by courts that have considered the issue, PDVSA and PDV Holding may have an uphill battle in attempting to prevent a new equity owner from exercising its control to replace the PDV Holding board of directors. Particularly against the background of existing unhelpful precedent under Section 362, PDVSA may attempt to argue in the alternative for an extension of the automatic stay under Section 105(a) of the Bankruptcy Code. While we are not aware of any precedent in this context, courts have extended the stay using their Section 105(a) powers in other arguably analogous contexts.[87] Of course, whether or not they are likely to be successful, we would expect PDVSA and PDV Holding to resist a corporate takeover by judgment creditors of PDVSA, at a minimum extending out the bankruptcy process likely by months.

ii. Challenging the CITGO Holding Pledge

If Crystallex and/or ConocoPhillips wrest control of PDV Holding from PDVSA, they may use their newfound control to focus on protecting PDV Holding's chief asset, its ownership of CITGO Holding, from its primary claimant: the 2020 Bondholders (and possibly Rosneft). For Crystallex, this would be a continuation of a preexisting feud. In October 2016, Crystallex brought an action against PDV Holding under DUFTA in Delaware federal court, alleging that its pledge of CITGO Holding stock to the 2020 Bondholders was a deliberate

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[82] *In re Marvel Entm't Grp.*, 209 B.R. 832, 833-34 (D. Del. 1997).

[83] *Id.* at 835.

[84] *Id.* at 839.

[85] *Id.*

[86] *See In re Johns–Manville Corp.*, 801 F.2d 60, 64 (2d Cir.1986).

[87] *See In re Lyondell Chemical Co.*, 402 B.R. 671 (Bankr. S.D.N.Y. 2009) (granting an injunction to extend the stay to protect guarantors for a limited period of 60 days to further restructuring efforts).

attempt to hinder Crystallex's ability to execute a potential judgment against PDV Holding in its 2015 DUFTA action.[88] Like Crystallex's two other Delaware court actions, this matter has been stayed pending the court's resolution of Crystallex's judgment enforcement and attachment action.[89]

At first glance, the Third Circuit's decision that DUFTA cannot reach PDV Holding's pledge because PDV Holding is not indebted to Crystallex would seem fatal to Crystallex's efforts to void the pledge. However, Crystallex has sought leave to amend its complaint to include allegations that PDV Holding is the agent or alter ego of Venezuela and/or PDVSA.[90] Provided that this effort is successful, Crystallex is likely to renew its challenge to the CITGO Holding pledge, and may in fact mount a similar challenge to the Rosneft pledge.[91] Interestingly, although the automatic stay imposed by the Bankruptcy Code would ordinarily prevent Crystallex from continuing to prosecute its case in Delaware federal court until after the PDV Holding bankruptcy concluded, a new PDV Holding board may be amenable to agreeing to lift the stay as to Crystallex—particularly to the extent Crystallex had a hand in electing the new directors. In fact, it is conceivable that the board may ultimately determine that continuing to contest the fraudulent nature of the pledge is not in the best interests of PDV Holding, thereby clearing the way for Crystallex to obtain an order voiding the pledge.[92]

d. A Potential Section 363 Sale and Possible Objections

Given existing U.S. policy, most notably the current sanctions that restrict the transfer of securities of the Republic or its instrumentalities (including PDVSA and its direct and indirect subsidiaries such as PDV Holding and CITGO Holding), it is difficult to foresee circumstances under which a PDV Holding plan of reorganization that resolves PDVSA liabilities could be confirmed.[93] Thus, the most likely nearer-term milestone for a PDV Holding bankruptcy is a sale of CITGO Holding shares (or other CITGO assets) under Section 363 of the Bankruptcy Code.[94] Specifically, we believe a Section 363 sale would occur much sooner and

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[88] *See Crystallex Int'l Corp. v. PDV Holding, Inc.*, No. 16-cv-1007 (LPS) (D. Del. Oct. 28, 2016), ECF No. 1.

[89] *See Crystallex Int'l Corp. v. PDV Holding, Inc.*, No. 16-cv-1007 (LPS) (D. Del. May 1, 2018), ECF No. 62.

[90] *See Crystallex Int'l Corp. v. Petróleos de Venez., S.A.*, No. 15-cv-01082 (LPS) (D. Del. May 26, 2017), ECF No. 85.

[91] A finding that PDVSA is the alter ego of PDV Holding could be in tension with Crystallex's attempt to void PDV Holding's stock pledge, given that the proceeds from the issuance of the 2020 Bonds were used largely to retire PDVSA debt. Indeed, if PDV Holding is deemed to be the same entity as PDVSA, it could become more difficult to argue that the pledge, an integral part of the issuance, was made "[w]ith actual intent to hinder, delay or defraud" Crystallex, rather than to serve the legitimate needs of PDVSA (and by extension its alter ego PDV Holding).

[92] This about face, even if supported by the business judgment of PDV Holding's board of directors, is all but guaranteed to spur the 2020 Bondholders to take action to intervene in the Crystallex suit to protect its interests.

[93] For example, Section 1129(a)(3) of the Bankruptcy Code requires that a plan of reorganization be "proposed in good faith and not by any means forbidden by law." 11 U.S.C. § 1129(a)(3). Courts have interpreted this statute as precluding confirmations of plans that "depend on illegal activity," *see e.g., In re Cook Invests. NW, SPNWY, LLC*, 2018 WL 1470848, at *2 (W.D. Wash. Mar. 26, 2018), and the executive orders that comprise the relevant sanctions have the force of law. *See, e.g., United States v. Messer Oil Corp.*, 391 F. Supp. 557, 561–62 (W.D. Pa. 1975) (noting that, as a general matter, "[r]egulations and Executive Orders when duly published have the force of law").

[94] Notably, because existing sanctions also restrict the transfer of securities *from* the Republic or its expansively defined instrumentalities, any purchaser will also likely require a license from the U.S. government exempting the transaction(s) from that prohibition.

we can see interested stakeholders favoring an expedited disposition of shares in CITGO Holding or even the operating assets of its subsidiaries rather than a prolonged Chapter 11 plan process —with creditors jockeying for position and engaging in intercreditor warfare. In such a proceeding, a central question will be whether PDV Holding would seek to sell all of its CITGO Holding shares or only the 51% subject to the 2020 Bond pledge. Although, as explained above, little is known about the terms of the Rosneft financing and pledge (including whether it would be in default at the time of the PDV Holding bankruptcy), there may be little incentive for PDV Holding to retain a minority stake in the CITGO business, particularly where existing U.S. sanctions prohibit the value generated by CITGO from flowing up to PDVSA or the Republic.[95] Moreover, a higher and better offer overall may be generated by bidders that could ultimately control the assets without the negative patina and reputational implications, not to mention corporate governance complications that would likely result from PDVSA's ongoing involvement.

A Section 363 sale can also minimize the types of intercreditor disputes that might ensue in a plan process, and secured creditors like the 2020 Bondholders (and perhaps Rosneft) would prefer to see their collateral monetized as soon as possible. In any event, there are myriad bases on which dissatisfied creditors could object to a Section 363 sale of CITGO Holding shares, including the sale's timing and its bidding procedures. Any or all of these can delay a Section 363 sale. If the secured creditors are unsatisfied with the terms of any sale, they may argue that the proposed sale, if permitted, would circumvent the creditor protections of the Bankruptcy Code that apply to a plan of reorganization, rendering the sale a "*sub rosa*" plan.[96]

Courts will reject Section 363 sales as *sub rosa* plans where the sale "seeks to allocate or dictate the distribution of sale proceeds among different classes of creditors" or otherwise attempts to restrict or extinguish the rights of creditors to vote on a plan of reorganization.[97] However, a Section 363 sale is not a *sub rosa* plan simply because the value generated through the sale is insufficient to satisfy all of a debtors' creditors, nor because it permits a purchaser to assume or reject prepetition executory contracts.[98] As a result, if PDV Holding structures its Section 363 sale so as to ensure that all other creditors will retain their right to vote on the eventual plan pursuant to which the sale proceeds will be distributed, it should be able to overcome a *sub rosa* objection.[99] At bottom, of course, any challenges to a Section 363 sale, and their likelihood of success, will be heavily dependent on the sale's procedures and structure. However, such a sale cannot likely be forestalled for long on these bases.

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[95] Relatedly, it is unclear whether Rosneft would take issue with a sale of the shares subject to its pledge, though if the sale generates enough value to satisfy its outstanding debts, it might be difficult to mount a serious challenge.

[96] *In re Gen. Motors Corp.*, 407 B.R. 463, 495 (Bankr. S.D.N.Y. 2009).

[97] *Id*.

[98] *See, e.g.*, *In re Trans World Airlines, Inc.*, 2001 WL 1820326, at *11 (Bankr. D. Del. Apr. 2, 2001). Furthermore, in the Second Circuit—where a PDV Holding bankruptcy is likely to be filed—a Section 363 sale is permissible if the bankruptcy judge finds "a good business reason" to permit the sale. *Comm. Of Equity Sec. Holders v. Lionel Corp (In re Lionel Corp.),* 722 F.2d 1063, 1071 (2d Cir. 1983).

[99] It should be noted, however, that the delay such an objection could cause, even if not ultimately sustained, may be damaging to PDV Holding and provide the objecting party or parties with leverage in negotiations regarding their underlying claims.

Instead, in terms of timing, as any PDV Holding bankruptcy drags on, creditors will have increasing leverage to either lift the stay or terminate exclusivity, the threats of which could lead to a Section 363 sale process—either preemptively by the debtors or as a consensual means to resolve exclusivity and lift-stay contested matters. While we believe that in the first several months of any proceeding (in which the Court would likely be deferential to the debtors), the debtors would be able to successfully resist any creditor efforts, such a Section 363 sale could begin in the first nine to twelve months of a PDV Holding bankruptcy. The timing for a broader resolution of competing claims through a plan of reorganization (including a PDVSA residual equity stake) is difficult to predict at this stage given the current U.S. limitations on distributions to PDVSA.

III. Conclusion

A PDV Holding bankruptcy may be one of the only methods for the Republic and PDVSA to protect CITGO from attack by their creditors if PDVSA decides to default on the large payment to 2020 Bondholders coming due in October 2018. It also may be one of the only means available to PDVSA to delay or postpone the loss of CITGO given the inability to sell its interests in CITGO due to U.S. sanctions. However, a bankruptcy could also prove to be the vehicle through which those same creditors ultimately succeed in their years-long efforts to collect on their debts and monetize PDV Holding's valuable downstream assets. The issues explored in this article are only the beginning.[100] The course of a bankruptcy proceeding is often unpredictable, with shifting alliances, quick turns of fortune and a plethora of legal and procedural mechanisms for participants to pursue their interests. Among all of those variables, one thing is certain: a PDV Holding bankruptcy would be closely watched and hotly contested.

[100] Indeed, a PDV Holding bankruptcy is sure to raise a host of other legal issues: we can see PDVSA and Republic creditors possibly seeking to have the bankruptcy court "substantively consolidate" the various CITGO debtors (which seems highly unlikely) or credit bidding their debt as part of a Section 363 sale of CITGO Holding shares (which is possible but complicated). We could also imagine non-parties, even Venezuelan citizens and members of the opposition, appearing and questioning the authority of PDVSA officials to take actions in the proceeding.