

## The State Of Creditor Recovery Efforts In Venezuela: Part 2

By **Richard Cooper** and **Boaz Morag** (June 5, 2018, 11:40 AM EDT)

This is the second part of a two-part article providing an update on the ongoing recovery efforts of creditors of the Republic of Venezuela and Venezuela's state-owned oil company, Petróleos de Venezuela SA, or PDVSA.

In part one of this article, we summarized the magnitude of the claims against PDVSA and the republic, those that are in various stages of enforcement proceedings, as well as the much larger pool of additional claims that could become the subject of judicial proceedings, followed by an update on the pending enforcement proceedings in the United States and elsewhere. In part two below, we discuss the implications of those enforcement proceedings and other litigation as well as recent political news for republic and PDVSA bondholders and other financial creditors who have not initiated any legal actions, but who may decide to do so in the near future.

### Implications for Republic and PDVSA Bondholders and Other PDVSA Financial Creditors

The next several weeks may shed a great deal of light on the question of how vulnerable the republic and PDVSA are to creditor collection efforts. During this period, we may learn what recovery ConocoPhillips may actually realize from its attachment efforts in the Antilles in light of the recent lifting of its attachment orders and what other strategies it may employ (after all, Conoco has been planning its enforcement strategy for years and is privy to difficult-to-find industry and market information about PDVSA given its involvement in the sector and global reach); whether Crystallex will be able to establish, at least for purposes of its judgment against Venezuela, that PDVSA is the republic's alter ego; whether the republic or PDVSA will seek and actually consummate settlements with either of these creditors before any decisions are rendered at all given the potential threats posed by their actions; and whether these litigation efforts prompt further litigation by individual creditors, groups of creditors, or bond trustees. Further, we should learn whether some of the initial procedural hurdles in the PDVSA Litigation Trust action will be overcome, such that the purported billions of dollars of value PDVSA was deprived of as a result of the activities of the defendants could potentially be made available to PDVSA (and potentially its creditors who may seek to intervene in such litigation).

The near future may also present decision points for the numerous holders of billions of dollars in



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defaulted republic and PDVSA bonds who to date have held off initiating legal proceedings.

PDVSA bond creditors will watch with interest to see whether PDVSA and PDVSA Petr leo will appear in White Beech's promissory note action in New York and if so, what defenses they raise.[1] PDVSA's bondholders, unlike those of the republic, are required to act through a trustee and do not have the right to commence individual suits. But if a trustee were to sue on a PDVSA bond issuance, the case could be a test for PDVSA's willingness to let bondholders obtain U.S. court judgments without opposition to the extent those judgments are limited to a money judgment for unpaid principal and interest.[2] Besides the burdens of inducing the trustee to act and the cost of indemnifying it, for some bondholders, U.S. law may create an economic incentive to refrain as long as possible from obtaining a money judgment, because under federal law, post-judgment interest would accrue at a considerably lower statutory rate than the default/contractual rate at which the bonds are currently accruing interest.[3] While there may be ways to neutralize or minimize this economic disincentive, such tactics will be complicated by the fact that, at least in the case of lawsuits brought against PDVSA, the actions will be brought by various trustees (depending on the bond issue), and holders may have less practical ability to cause the trustee to adopt specific strategies to mitigate these issues.

Another potential option open to PDVSA bondholders who have convinced a trustee to pursue legal action is to attempt to replicate ConocoPhillips's Antilles strategy. To the extent that the partial lifting of the attachments by the Antilles courts still leaves PDVSA's subsidiary vulnerable to attachment, there may be merit to seeking to replicate the strategy. Any such gambit would also have to take into consideration whether PDVSA has developed or will be able to develop a workaround to minimize the effect of ConocoPhillips's already-issued attachment orders. Assuming there is value in following the lead of ConocoPhillips, PDVSA bondholders would be in a legal position to do so; PDVSA Petr leo is the guarantor of all PDVSA bonds and thus every PDVSA bondholder also has a claim against PDVSA Petr leo, which is known to have assets in the Netherlands Antilles. We understand that Antilles courts may issue multiple conservatory attachments over the same assets, such that ConocoPhillips has not established a priority that would block other creditors. Rather, if multiple attachments are issued, even if ConocoPhillips' attachment would become executory ahead of those of other creditors by its obtaining an Antilles court judgment, the later-in-time creditors holding conservatory attachment orders would still be entitled to share in the proceeds from the disposition of the assets and that sharing would be on a *pari passu* basis. Of course, going down the road of attaching PDVSA Petr leo assets as a first step would require the trustee, if successful, to initiate within a matter of weeks litigation in New York, or some other forum in which PDVSA and PDVSA Petr leo are subject to jurisdiction, to litigate their bond claims and obtain a judgment; otherwise the conservatory attachments in the Antilles would be lifted.

PDVSA bondholders should also closely monitor developments in the PDVSA U.S. Litigation Trust suit. At some point in the future, if the trust succeeds in obtaining judgments or settlements against the defendants, the trust may recover funds. At that point, it may be possible for PDVSA bond creditors to intervene and prevent the trustees from disbursing PDVSA's share of the proceeds they have collected and to seek a prejudgment attachment of PDVSA's interest in that recovery. Such prejudgment relief is available given the breadth of PDVSA's waiver of immunity in its bond indentures.

Republic bondholders are free to sue individually without the need for any trustee action on their behalf, but they face the same cost and financial issues as PDVSA bondholders of whether to incur the expense of litigation (and time commitments that flow from such efforts) and the reduction in the accruing interest rate once a judgment is entered. Any republic bondholder that obtains a judgment will not be susceptible to being crammed down through the use of the collective action provisions in the republic's bond documentation. On the other hand, the enforcement options open to holders of

judgments against the republic are more limited than to holders of judgments against PDVSA.

The republic is not known to have nonimmune assets in its name in the Antilles or elsewhere that are readily attachable.[4] In the United States, pursuit of the primary assets here — PDVSA’s shares in PDV Holding — first requires an alter ego finding, which, if made in either the Crystallex or Rusoro proceedings, may result in the PDV Holding shares being attached by one of those creditors, with no substantial value left for republic bondholders. This assumes that the alter ego determination in favor of Crystallex and/or Rusoro is based on the “exclusive dominion and control” prong of the alter ego test (and not the “fraud and injustice” prong”) since that prong of the alter ego analysis is more easily relied upon by a republic bondholder than the fraud and injustice prong, which is more suited to an expropriation victim than the purchaser of a bond instrument. As noted in our prior article, Crystallex alleges facts relating to the transfer of expropriated property rights to PDVSA by the republic (also alleged by Rusoro), which, if accepted by the U.S. courts, would qualify as a “fraud or injustice” that would strengthen the arguments in favor of an alter ego finding.[5] Republic bondholders, however, would have to show and rely on the republic’s control of PDVSA’s day-to-day operations alone and are not likely to be able to rely on the argument that failing to pierce the veil would result in a “fraud or injustice.”[6]

For republic and PDVSA bondholders, a wait-and-see strategy may make more sense for the time being, at least until some of the events that are expected to occur over the next few weeks have played out.

It would seem that the creditors in the best position to litigate are holders of the promissory notes issued by PDVSA and guaranteed by PDVSA Petróleo. Such noteholders can sue individually without any trustee, and can aggressively pursue collection of the face amount of notes, which they likely purchased at steep discounts. Historically, the creditors who have pursued the most aggressive litigation and enforcement strategies in the sovereign context are those who acquired interests at steep discounts and can afford the costs of such litigation and the reduction in post-judgment interest that such litigation may entail (or those that have used provisions such as the pari passu clause in the bond documents to prevent the sovereign from servicing its restructured debt, a strategy that may be more difficult today following more recent decisions in this area and assuming Venezuela avoids certain missteps that the U.S. courts have focused on in this context). Most holders of the PDVSA promissory notes fall into this category, and, consequently, we would not be surprised to see more of these suits.

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[1] One interesting aspect of the White Beech complaint is that it essentially treats both PDVSA and PDVSA Petróleo as private parties rather than as agencies or instrumentalities of Venezuela under the Foreign Sovereign Immunities Act, or FSIA. Compl. at ¶ 5, *White Beech SNC LLC v. Petroleos De Venezuela SA*, No. 18-04148 (S.D.N.Y. May 9, 2018), ECF No. 1. PDVSA is unquestionably subject to the FSIA as it is wholly owned directly by the republic. Whether PDVSA Petróleo is an “organ” of Venezuela, and thus also subject to the FSIA, is an interesting question that has not been addressed in the Second Circuit. PDVSA Petróleo was found to be an “organ” of Venezuela in *RSM Prod. Corp. v. Petroleos de Venezuela SA*, 338 F. Supp. 2d 1208, 1214-15 (D. Colo. 2004), but the analysis of the issue in that case

was fairly superficial. Were PDVSA Petr leo not covered by the FSIA, then that would in theory expand a U.S. court's enforcement powers by permitting it to order PDVSA Petr leo to transfer property into the United States to satisfy a judgment that it could not order a foreign sovereign subject to the FSIA to do.

[2] In the relatively early days of the Argentina litigation, the New York federal court adopted in consultation with Argentina's counsel and with its consent a streamlined summary judgment procedure that facilitated Argentine bondholders promptly obtaining a federal court money judgment for principal and interest.

[3] Although the trustee could sue PDVSA and PDVSA Petr leo in New York state court, where judgments accrue interest at the rate of 9 percent, PDVSA would almost certainly remove such a lawsuit prejudgment to federal court even if it were to no longer participate once the case was pending in federal court.

[4] Even with the republic's complete waiver of immunity in its bond offering documents, the only Venezuelan assets in the United States that may be enforced against are those "used for a commercial activity in the United States." 28 U.S.C.   1610(a)(1).

[5] See Richard J. Cooper and Boaz S. Morag, Third Circuit Dismissed Crystallex's Fraudulent Transfer Claim But Potential Liability Remains for PDVSA (Jan. 5, 2018), available at <https://www.clearlygottlieb.com/~media/files/third-circuit-dismisses-crystallexs-fraudulent-transfer-claim--cooper--morag-crystallex-dufta-3d-cir-article-1-5-2018.pdf>.

[6] See *id.*