the Outlook for 2018

U.S. Economic and Trade Sanctions Against Venezuela

March 13, 2018

Panelists:
Jose W. Fernandez
Adam M. Smith
Christopher T. Timura

Moderator: Judith Alison Lee
**Jose W. Fernandez** is Co-Chair of the firm’s Latin America Practice Group. He previously served as Assistant Secretary of State for Economic, Energy and Business Affairs in the Obama Administration, overseeing the bureau’s work on international trade and investment policy, international finance, development and debt policy, economic sanctions, and other international business issues. His practice focuses on M&A and finance in emerging markets.

**Judith Alison Lee** is Co-Chair of the firm’s International Trade Practice Group. She focuses her practice in the areas of international trade regulation, including USA Patriot Act compliance, FCPA, economic sanctions and embargoes, and export controls, and also assists clients with issues involving virtual and digital currencies, blockchain technologies and distributed cryptoledgers.

**Adam M. Smith** previously served in the Obama Administration as the Senior Advisor to the Director of OFAC and as the Director for Multilateral Affairs on the National Security Council. His practice focuses on international trade compliance and white collar investigations, including economic sanctions enforcement, FCPA, embargoes, and export controls.

**Christopher T. Timura** is a member of the firm’s International Trade Practice Group. His practice focuses on export controls, economic sanctions, and national security compliance, licensing and investigations, and represents clients before the Departments of State (DDTC), Treasury (OFAC and CFIUS), Commerce (BIS), Homeland Security (CBP), and Justice.
Agenda

- Venezuela Country Conditions and U.S. Foreign Policy Making
- Evolution and Current U.S. Sanctions on Venezuela
- Export Controls on Venezuela
- Policy Making Through OFAC General Licenses and FAQs
- What’s Next
- Hypotheticals
Venezuelan Economy
Declining Revenue and Rampant Inflation

**Reuters, November 13, 2017**
Venezuela crude output hits 28-year low: OPEC

**BBC News, November 14, 2017**
Venezuela in selective default, says credit ratings agency

**NY Times, Dec. 13, 2017**
*Once a Cash Cow, Venezuela’s Oil Company Now Verges on Collapse*

**CNN Money, Jan. 25, 2018**
Half the Venezuelan economy has disappeared

Source: IMF. (*) indicates figure projected as of October 2017
Life in Venezuela
Severe Shortages

• Nearly 90% of Venezuelans live in poverty.

• Food is largely imported and in severe scarcity as the Maduro government reduces imports in order to meet its debt payments.
  ▪ Imports of food and other necessities reduced by 30% in 2017 to meet $10 billion in debt payments.
  ▪ The average Venezuelan lost 24 pounds in 2017 due to food shortages.
  ▪ Child malnutrition exceeds the WHO’s crisis threshold.

• Severe shortages affecting the healthcare system.
  ▪ 1/5 of medical personnel have fled the country in the past 4 years.
  ▪ Hospitals lack basic supplies: 1/2 have shortages of beds, 3/4 are missing basic medications, and 1/5 lack drinkable water.
  ▪ Significant effects on health, including outbreaks of preventable or treatable disease, and increasing mortality rates (e.g., a 100x increase in newborn mortality between 2012 and 2015).

Life in Venezuela
Emigration

- Over 1 million Venezuelans have left the country – out of a country of ~31 million.

- Over half of young adults in Venezuela want to leave the country.

- Over 600,000 Venezuelans have fled to Colombia, where officials have tightened border controls, and have traveled to camps for Syrian refugees in Turkey to learn best practices.

- Other destinations for Venezuelan refugees include Trinidad & Tobago (~40,000), Brazil (~30,000), and Aruba (~20,000).

Sources: “Over half of young Venezuelans want to flee as economy collapses, poll finds,” The Guardian (Mar. 8, 2018); Shannon K. O’Neil, “Venezuela’s Neighbors Can’t Wait for Uncle Sam,” Council on Foreign Relations (Feb. 27, 2018); “Migrate or die: Venezuelans flood into Colombia despite crackdown,” Reuters (Feb. 26, 2018); UNHCR, “Venezuela Situation” (November 2017); CIA World Factbook.
Venezuela’s Collapsing Oil Production and Processing Infrastructure

Oil exports constitute 95% of Venezuela’s export revenue.

In November 2017, Maduro arrested the heads of both the Energy Ministry and PdVSA and replaced them with a general and a former housing minister, respectively.

PdVSA’s refineries will operate at 43% of capacity in March 2018 due to lack of spares, feedstock, and light crude.

Underfed workers are less able to do their jobs. Some have passed out at their work stations. Others, too weak for demanding labor, are sent home. Workers who stay on the job have to do more, sending them deeper into calorie deficit. They are less able to quickly respond to the technical and mechanical problems.

History of Venezuela Sanctions

**December 18, 2014:**

**March 8, 2015:**
EO 13692 implements sanctions against persons implicated in human rights abuses and anti-democratic activities.

**August 24, 2017:**
EO 13808 imposes sectoral sanctions on the Government of Venezuela and PDVSA.

**Earlier:**
No Venezuela-specific OFAC program, but some Venezuelan persons designated under global programs, such as the Kingpin Act sanctions.
Venezuela Freezing Sanctions
Primarily Individuals
All Blacklisted

**EO 13692**
51 individuals are sanctioned under this authority as of March 2018, including current or former senior prosecutors, politicians, and members of the armed forces, national police, and/or intelligence services.

- Haringhton Padron Dep. Prosecutor
- Benavidas Torres Former Nat’l Guard
- González López Nat’l Intelligence
- Nicolás Maduro President
- Zerpa Delgado VP PDVSA

**Kingpin Act**
25 Venezuelan individuals or entities are sanctioned under this authority as of March 2018, including large corporations, airlines, and senior government officials.

- Bernal Rosales Min. Agriculture
- Rodríguez Chacin Fmr. Minister
- Makled Garcia
- El Aissam VP of Venezuela
Venezuela Sectoral Sanctions (EO 13808)
Organizations
Not Blacklisted

Section 1. (a) All transactions related to, provision of financing for, and other dealings in the following by a United States person or within the United States are prohibited:

(i) new debt with a maturity of greater than 90 days of Petroleos de Venezuela, S.A. (PdVSA);
(ii) new debt with a maturity of greater than 30 days, or new equity, of the Government of Venezuela, other than debt of PdVSA covered by subsection (a)(i) of this section;
(iii) bonds issued by the Government of Venezuela prior to the effective date of this order;
(iv) dividend payments or other distributions of profits to the Government of Venezuela from any entity owned or controlled, directly or indirectly, by the Government of Venezuela.

(b) The purchase, directly or indirectly, by a United States person or within the United States, of securities from the Government of Venezuela, other than securities qualifying as new debt with a maturity of less than or equal to 90 or 30 days as covered by subsections (a)(i) or (a)(ii) of this section, respectively, is prohibited.

Sec. 2. (a) Any transactions that evade or avoid, or the purpose of evading or avoiding, causes a violation of, or attempts to violate any of the prohibitions set forth in this order is prohibited.

(b) Any conspire to violate any of the prohibitions set forth in this order is prohibited.

Sec. 3. For the purposes of this order:
(a) the term “person” means an individual or entity;
What Activities Does EO 13808 Prohibit?

- EO 13808 prohibits certain transactions by U.S. persons related to:
  - new debt of Petróleos de Venezuela, S.A. (PdVSA);
  - new debt and new equity of the Government of Venezuela;
  - bonds issued by the Government of Venezuela before August 25, 2017;
  - the purchase of securities from the Government of Venezuela; and
  - the payment of dividends and other distribution of profits to the Government of Venezuela by entities owned or controlled by the Venezuelan government.
What EO 13808 Does Not Do...

• It does not block *all* transactions with the Government of Venezuela or PdVSA.
• It does not add the Government of Venezuela or PdVSA to the SDN List.
• It does not prohibit *all* transactions involving nor does it block the property of the Government of Venezuela or PdVSA.

Why did the Administration opt to impose “half measures” like these? Why didn’t OFAC blacklist major companies (like PdVSA) or even the jurisdiction of Venezuela?

OFAC faced a very similar problem with respect to Venezuela as it has with respect to Russia – how to impose the strongest possible sanctions while limiting the negative collateral consequences?

In Russia the concern was blowback against our European allies (so many of which remain reliant on Russian energy).

In Venezuela the concern was a combination of continued U.S. reliance on Venezuelan oil, the protection of U.S. jobs in refineries on the Gulf coast, and concerns about the impact of a possibly failed stated in Latin America (if the country imploded).
Broader Effects of Freezing Sanctions

• The potential impact of a broader set of freezing measures can be seen in the more limited case of how can U.S. persons deal with PdVSA when some of its leadership are sanctioned parties?

• OFAC takes the position that U.S. persons may not enter contracts signed by an SDN, even if the SDN is an individual acting in a professional capacity on behalf of an entity that is not blocked.

Furthermore, the plain language of the Ukraine-Related Sanctions Regulations (which were issued after the Executive branch statements) and E.O. 13661 do not contain a “personal” versus “professional” distinction, and OFAC has neither interpreted its Regulations in that manner nor endorsed such a distinction. The press release statements provided context for the policy.

• In 2017, a U.S. multinational company was assessed a civil monetary penalty of $2,000,000 based on this theory in connection with the Ukraine-related sanctions.

• Recent designations of significant executives (such as PdVSA’s VP of Finance) may substantially affect U.S. persons’ ability to deal with those entities, even though the entities are not blocked.
• EO 13808 prohibits U.S. person involvement in any transaction related to:
  ▪ new debt with a maturity of greater than 90 days of PdVSA;
  ▪ new debt with a maturity of greater than 30 days, or new equity, of the Government of Venezuela

• What does OFAC mean by “debt”?
  ▪ OFAC interprets the term “debt” very broadly.
  ▪ For example, OFAC considers a party that provides goods or services and then bills the recipient by issuing an invoice requiring payment by a certain date to be extending credit, so requiring payment within 30 days would be considered “debt with a maturity date of 30 days.”

• NOTE: Though the sectoral sanctions imposed against Russia are similar to those imposed against Venezuela, OFAC has warned parties against assuming that the interpretations and guidance provided in one program are applicable in any other program.
What happens to debt pre-dating the sanctions?

• All the prohibitions extend to rollover of existing debt, if such rollover results in the creation of new debt with a maturity of longer than 90 days for PdVSA and 30 days for the Government of Venezuela.

• The terms for old debt are still valid even after sanctions were implemented, but once the old debt “matures” and enters a new term, the debt cannot exceed the 90 day and 30-day requirement.

• It is only the extension of the new debt post-August 25 that triggers the new sanction prohibitions, and must be compliant with the 30 days (GoV) or 90 days (PdVSA).
When does “old debt” become “new debt”?

- **Old debt = debt predating August 25, 2017**
  - Ex: Unpaid PdVSA invoice dated February 1, 2016 with maturity date of 150 days
    - Not subject to EO sanctions. If payment received on e.g. December 1, 2017, bank can process the payment even though payment received post-sanctions and past-due.
    - But, only if the terms of the debt (payment deadlines, interest rate, etc.) have not changed subsequent to August 25, 2017.

- **New debt = debt (bills, credit, loan agreements) post-August 25**
  - Ex: Unpaid PdVSA invoice for a service received August 27, 2017
    - Subject to EO sanctions and payment must be received within 90 days.

- **Rollover = when an old debt with a due date post-August 25, 2017 is not paid, the debt “rolls over” into a new term and is considered a new debt.**
  - Ex: Unpaid GoV invoice dated May 1, 2017 with October 1, 2017 due date. PdVSA does not pay until October 5, 2017. The debt rolled over after October 1, but payment was received within 30 days of the roll-over date.
  - Ex: Same facts as above, but payment is not received until November 5, 2017. The payment was not received until past the 30-day requirement and is in violation of sanctions.
Venezuela is an International Traffic in Arms Regulations (ITAR), Section 126.1 country – which means that exports to Venezuela are subject to a policy of denial for all ITAR-controlled defense articles and services. The State Department first imposed this restriction in August 2006.

Only items subject to Export Administration Regulations (EAR) can be exported or reexported to Venezuela

EAR Exports and reexports are subject to Item-based, Policy Driven Controls
The EAR also impose Military End-Use and End-User Controls on Venezuela, 15 C.F.R. 744.21

What are Military End-Use and End-User controls?
Independent licensing requirement on a set of additional items subject to the EAR if you have knowledge – i.e. you know or have reason to know – that items will be put to a military end-use or end-user

- “Military End Use” means incorporation into military item on Wassenaar Arrangement Munitions List, incorporation into “A018” or “600 Series” ECCNs; “development,” “production,” or “use” of military items described on the USML or the Wassenaar Arrangement, or deployment of items classified under ECCN 9A991.

- “Military End Users” include national armed services (army, navy, marine, air force, or coast guard), as well as the national guard and national police, government intelligence or reconnaissance organizations, or any person or entity whose actions or functions are intended to support ‘military end uses.’
If either Item-based or End-User or End-Use Controls apply, then Bureau of Industry (BIS) and Security authorization is required

**Interagency Review**
BIS is only the “front office” for licensing applications; actual review is interagency

Which other agencies are involved can vary, but generally

- **Department of Commerce** reviews
  Technical issues (National Security, non-proliferation and others)
  Economic issues
- **Department of Defense** reviews
  National security issues – Brings the technical expertise of the Services focused on an individual export/re-export
- **Department of Energy** reviews; and
  Nuclear and missile issues
- **Department of State** reviews
  Foreign policy issues
On November 13, 2017 the EU Council decided to impose an arms embargo on Venezuela.

Regulation also includes a prohibition on the sale, supply, transfer or export, directly or indirectly, of equipment which might be used for internal repression, including equipment, software and technology that can be used to track and monitor opponents’ use of the Internet, email, texting and instant messaging.

It is also prohibits, without authorization, provision of technical and financial services for such items.

- to provide, directly or indirectly, technical assistance or brokering services related to the equipment, technology and software;
- to provide, directly or indirectly, financing or financial assistance related to the equipment, technology and software; and
- to provide any telecommunication or internet monitoring or interception services of any kind to, or for the direct or indirect benefit of, Venezuela's government, public bodies, corporations and agencies or any person or entity acting on their behalf or at their direction.
The Regulation also introduced a legal framework for travel bans and asset freezes against those involved in human rights violations and non-respect for democracy or the rule of law.

- Article 8 of the EU Venezuela Sanctions Regulation also sets up the legal framework for an asset freeze and prohibits that no funds or economic resources shall be made available, directly or indirectly, to or for the benefit of natural or legal persons, entities or bodies listed in Annexes IV and V of the EU Venezuela Sanctions Regulation. This approach is similar to an SDN listing in the U.S.

- On January 22, 2018 an initial list of seven individuals was published who were subject to these sanctions (the asset freeze and the prohibition that no funds or economic resources shall be made available, directly or indirectly, to or for the benefit of these listed individuals).
EU Sanctions and Export Control Developments
Regulation (EU) 2017/2063 (the “EU Venezuela Sanctions Regulation”)

EU designated officials include

- Diasdado Cabello Rondon – Former National Assembly President
- Nestor Luis Reverol Torres – Interior Minister
- Maikel Jose Moreno Perez – Chief Justice
- Gustavo Enrique Gonzalez Lopez – Head of National Intelligence Service
- Tibisay Lucena Ramírez – President of the National Electoral Council
- Antonio Jose Benavides Torres – Chief of the Capital District Government
- Tarek William Saab Halabi – Attorney General

All have been sanctioned by OFAC, with one exception.
Calibration of U.S. Sanctions – Licenses and FAQs

• An increasingly common strategy for U.S. sanctions has been to impose very broad sanctions on entities or jurisdictions and then modulate restrictions over time by issuing licenses (both “General” and “Specific”) and Frequently Asked Questions (FAQs) that provide the agency’s interpretations on aspects of the regulations.

• OFAC has done both in the context of Venezuela sanctions.

• Core General Licenses (regulatory exemptions) include:

  ▪ **GL 1:** provided a grace period through 09/24/17 authorizing transactions otherwise prohibited by the E.O. that were necessary to winding down contracts.

  ▪ **GL 2:** authorizes most, but not at all, transactions involving new equity, debt, and other securities for CITGO Holding, Inc. and any of its subsidiaries.

  ▪ **GL 3:** authorizes all transactions related to particular Venezuelan government bonds specifically listed by OFAC.

  ▪ **GL 4:** authorizes transactions related to new debt related to the exportation or reexportation from the U.S. or by a U.S. person of agricultural commodities, medicine, medical devices, or replacement parts.
Limited “Business as Usual” General Licenses Due to Ongoing Significant U.S.-Venezuela Business

GL 1  Allowed for an orderly wind-down

GL 2  Aims to allow for continued operations of CITGO – but eliminates the ability to of CITGO to serve as a source of funding for the Venezuelan Government

GL 3  Recognizes the dozens of outstanding bonds worth billions of dollars held by U.S. Persons and seeks to protect the assets of innocent U.S. investors

GL 4  A near-standard general license in sanctions programs that exempts the provision of food and medical goods from restrictions

“To mitigate harm to the American and Venezuelan people, the Treasury Department is issuing general licenses that allow for transactions that would otherwise be prohibited by the Executive Order....”
White House, August 25, 2017

Note: It is uncommon for any Administration to have explicitly called out U.S. investors and its desire to mitigate any harm investors may suffer due to sanctions.
Limited “Business as Usual” Statement of Licensing Policy to allow for Specific Licenses – Allowing Receipt of New Debt

1. PdVSA is in debt to the applicant

2. The debt is “new debt” created before March 14, 2018

3. Relevant segment of the Government of Venezuela/PdVSA has failed to pay within the agreement upon, authorized payment period

4. Transaction is not otherwise prohibited by sanctions (no sanctioned persons, etc.)

If so, a Specific License could be issued

“To mitigate potential harm to U.S. persons who have not received payment related to new debt incurred by PdVSA or another segment of the Government of Venezuela within the applicable maturity period, OFAC will, on a case-by-case basis, grant specific licenses to U.S. persons to deal in the collection or receipt of such payment....”

OFAC – FAQ 554

Note: It is not clear what happens after March 14, 2018 (require pre-payment?) nor the impact of an ever greater number of senior Venezuelans being sanctioned.
Limited “Business as Usual” Statement of Licensing Policy to allow for Specific Licenses – Allowing Renegotiation of Debt

In November 2017 Venezuela went into “technical default” as it was late on certain bond payments. While the country appears to have managed to pay its bonds since November 2017 (and it remains for now not in default and bond holders have not launched legal action) there are numerous questions regarding the ability of U.S. Persons who hold much of this debt to enter into debt renegotiation with Venezuela to secure at least part of their investment. **The problem for U.S. persons is two fold:**

1. Renegotiation of a bond that would allow for a greater than 30- or 90-day term would be the creation of “new debt” – OFAC issued FAQ 547 to address this issue. The FAQ states that U.S. persons can enter in discussions with Venezuela regarding renegotiation so long as the bonds in question are listed under General License 3. However, U.S. persons still need an OFAC license to actually transact in any new debt that is created.

2. However, U.S. Persons are not allowed to engage in any dealings with persons who are sanctioned. Venezuela has asked two persons who are sanctioned to lead any renegotiation effort on behalf of the State.

This unlikely constellation of factors has led some to conclude that a “successful [debt] restructuring by the Maduro regime appears impossible.” *Economist Intelligence Unit*, November 16, 2017
After many months of hinting that it was about to do so, on Tuesday, February 22, 2018 Venezuela launched a new “cryptocurrency.” Though most observers suggest that the currency is more likely to fail than to succeed, one of its primary purposes is an attempt by President Maduro to unshackle his U.S. dollar-based economy from U.S. sanctions.

Unlike other digital currencies whose value fluctuates based on demand, the Petro is based on the value of Venezuela’s hydro-carbons Maduro claimed that the country raised $735 million in the Petro’s first day and that he seeks to raise $6 billion in total from foreign investors as they seek a way out of sanctions restrictions.

OFAC’s Response: the agency published an FAQ holding that a U.S. person that deals in this digital currency may be exposed to U.S. sanctions risks.

While this was OFAC’s first-ever formal statement regarding its jurisdiction over cryptocurrencies the fact that the Petro is structured as a mini-bond (as it allows holders a call on future production) likely made it much easier for OFAC to determine that dealing in the Petro was akin to dealing in long-term debt of the Government of Venezuela (which is already prohibited).
Difficult to predict, but here are some “guard rail” policy factors that would normally inform decision making.
The Trump Administration

“We will not stand by as Venezuela crumbles.”
-- White House, August 25, 2017 (announcing E.O. 13808)

“The circumstances described in Executive Order 13692 and Executive Order 13808 have not improved, and they continue to pose an unusual and extraordinary threat to the national security and foreign policy of the United States.”
-- White House, March 2, 2018

The Trump administration is reportedly considering further sanctions, such as targeting Camimpeg or restricting insurance coverage for Venezuelan oil shipments.

The *Empresas Mixtas* Problem

CITGO REFINING

Our refineries transform crude oil into the energy products people need. As we manufacture these products, our top priorities are safety and environmental stewardship. Click on the links below to learn more about our individual refineries.

Source: http://citgorefining.com/
Refugee Crisis
I am a U.S. person investor and owed $3.2 million on a VZ bond, which is now past due 60 days. There is a 90 day window before certain default provisions in the bond offering are triggered and I was just invited to attend a meeting with a VZ government official in Caracas to discuss the payment. Can I go?
I am an oil services provider and we entered into a contract with an entity owned 31 percent by PdVSA and 69 percent owned by Citgo Holdings. The contract date was dated just before the effective date of the Executive Order 13808. I will soon complete the service contract and the contract allows payment within 120 days. The entity I contracted with has now asked whether I could accept payment in three installments over the next 180 days. Can I accept this new payment plan?
I just read in the papers that the PdVSA and Russian oil company Rosneft negotiated a deal to allow Rosneft to develop two new VZ offshore blocks. I sell exploration and production equipment. Can I sell my equipment and services to support this new venture?
Firm publications are available for download on the Gibson Dunn website at:
- https://www.gibsondunn.com/category/publications/

Selected International Trade Sanctions Client Alerts:

- February 5, 2018
  2017 Year-End Sanctions Update – Read Here

- November 21, 2017
  Trump Administration Implements Congressionally Mandated Russia Sanctions – Significant Presidential Discretion Remains – Read Here

- November 16, 2017
  Cuba Sanctions: The Trump Administration Takes Steps to Implement Rollback of Obama Era Sanctions Relief – Read Here