

May 31, 2018

PRESIDENT TRUMP ISSUES ADDITIONAL SANCTIONS FURTHER TARGETING PdVSA AND THE GOVERNMENT OF VENEZUELA

To Our Clients and Friends:

On May 21, 2018, in response to the reelection of Venezuelan President Nicolás Maduro, President Donald J. Trump imposed additional sanctions against the Government of Venezuela.^[1] The new sanctions prohibit U.S. persons from engaging in certain dealings in debt owed to the Government of Venezuela and equity of Venezuelan state-owned entities. In this regard, these sanctions build upon prior Venezuela-related sanctions to further restrict financing available to the current Venezuelan government.

In a statement released with the executive order, President Trump noted that the sanctions are designed to prevent the Maduro regime from selling off valuable state-owned assets in "fire sales," which deprive the Venezuelan people of "assets the country will need to rebuild its economy."^[2] In many senses this executive order represents a protective measure. Furthermore, selling and collateralizing debt owed to and equity held by the Venezuelan government sidesteps other U.S. sanctions to provide alternative means of financing state-owned enterprises, such as Petroleos de Venezuela, S.A. ("PdVSA"), which fund support for the Maduro regime.^[3] The new sanctions are meant to close off this potential funding stream without incurring the collateral costs associated with adding PdVSA to the Specially Designated Nationals ("SDN") list.

Notably, the U.S. Treasury Department's Office of Foreign Assets Control ("OFAC")—which is also immersed in the tasks of issuing guidance related to new Russia and Iranian sanctions—has not provided any general licenses, interpretive guidance, or additional statements regarding this executive order or the sanctions it imposes.

OVERVIEW OF NEW SANCTIONS

The executive order specifically prohibits the following transactions in debt owed to and equity held by the Government of Venezuela. As in earlier executive orders, the "Government of Venezuela" includes not only its political subdivisions, agencies, and instrumentalities but also the Central Bank of Venezuela, PdVSA, and any entity that is at least 50 percent owned or controlled by these targeted entities (including, for example, PdVSA subsidiaries and majority-owned joint ventures).^[4]

(1) Transactions involving the purchase of any debt owed to the Government of Venezuela, including accounts receivable.^[5]

The executive order prohibits U.S. persons from engaging in transactions involving the purchase of debts owed to the Government of Venezuela. For example, pursuant to this prohibition, a U.S. person may

not purchase from PdVSA a debt it is owed by a non-sanctioned customer. Importantly, this provision prohibits not only U.S. persons from buying debts owed to the Venezuelan government but also broadly prohibits U.S. persons from engaging in any transactions related to the purchase of such debts. For example, a U.S. bank may not provide financing for one entity to purchase the debt that another entity owes the Government of Venezuela.

As in other Venezuela-related sanctions, debt subject to this prohibition includes bonds, loans, extensions of credit, loan guarantees, letters of credit, drafts, bankers acceptances, discount notes or bills, or commercial paper.^[6] Although accounts receivable are expressly included as debt in this provision, their inclusion here does not represent an expansion of OFAC's interpretation of debt. Rather, OFAC has generally considered trade debt, including accounts receivable, to be debt subject to prior Venezuela-related sanctions and other similar sanctions.^[7] The explicit inclusion of accounts receivable in these provisions highlights the type of transaction that the sanctions are primarily aimed at stopping and for which compliance professionals should screen.

(2) Transactions involving any debt owed to the Government of Venezuela that is pledged as collateral after the effective date of this order, including accounts receivable.^[8]

The executive order also prohibits U.S. persons from dealing in debt owed to the Government of Venezuela that is pledged as collateral after May 21, 2018. OFAC has not provided any interpretative guidance regarding what constitutes "collateral" for the purposes of this provision, but it likely refers to debt, as defined above, which is offered as security for a loan made to the Government of Venezuela. This provision only covers debt pledged as collateral after May 21, 2018. It does not prohibit U.S. persons from dealing in the transfer of debt owed to the Government of Venezuela that was pledged as collateral on or before May 21, 2018. However, OFAC has also not provided additional information regarding when it will consider a debt to be "pledged" for the purposes of determining when such debt is covered by this provision. It is likely that debt is pledged upon the execution of the agreement offering the debt as collateral.

This provision directly curtails the ability of the Venezuelan Government to use accounts receivable financing to support its continued operation. For example, a U.S. person would likely be prohibited from participating in transactions between a PdVSA customer and a PdVSA creditor where the customer paid its outstanding debt to the creditor, in lieu of payment by PdVSA.

While similar in some respects to prior sanctions targeting debt transactions, these new prohibitions include several notable differences. First, the provisions restrict transactions involving debt owed *to* the Government of Venezuela, rather than debt owed *by* the Government of Venezuela to its creditors.^[9] Second, there is no exception for dealings in short-term debt. Where prior Venezuela sanctions permitted transactions in debt with payment terms less than 30 or 90 days (depending upon the debtor), debts with payment terms of any length are covered by this executive order.^[10] Finally, these prohibitions are not limited to "new debt" issued after a specified date.^[11] Instead, all debts owing to the Government of Venezuela, regardless of when they were issued, are covered. The novelty of these features poses additional compliance challenges for U.S. businesses and financial institutions.

(3) Transactions involving the sale, transfer, assignment, or pledging as collateral by the Government of Venezuela of any equity interest in any entity in which the Government of Venezuela has a 50 percent or greater ownership interest.[12]

Pursuant to this provision, U.S. persons are broadly prohibited from engaging in transactions in which the Government of Venezuela is selling, transferring, assigning, or collateralizing equity interests in Venezuelan state-owned entities. As in prior sanctions, "equity" includes stocks, share issuances, depositary receipts, or any other evidence of title or ownership.[13] In that regard, this prohibition prevents the Maduro government from selling shares in state-owned entities to finance their continued operation.

Unlike certain prior provisions restricting equity transactions involving the Venezuelan government, this provision is not limited based on the date the relevant equity was issued.[14] Instead, all equity interests in any entity majority-owned by the Venezuelan government are subject to this prohibition, regardless of when the equity was issued. Relatedly, where other prior sanctions prohibited U.S. persons from participating in the purchase of equity from the Venezuelan government, this provision now prohibits U.S. persons from participating in a broader range of transactions involving such equity.[15]

Importantly, this prohibition covers transactions involving Venezuelan government sale, transfer, assignment, or collateralization of equity interests in CITGO. When sanctions on Venezuelan government debt or equity were imposed in August 2017, OFAC issued a general license effectively carving out CITGO, PdVSA's U.S. subsidiary, from those restrictions.[16] OFAC has offered no such authorization here. Consequently, in the absence of a license from OFAC, U.S. persons are prohibited from dealing in CITGO shares offered for sale, transfer, assignment, or collateral by the Government of Venezuela, including PdVSA.

EUROPEAN UNION RESPONSE

On May 29, 2018, the EU Foreign Ministers noted that the EU will "act swiftly, according to established procedures, with the aim of imposing additional targeted and reversible restrictive measures, that do not harm the Venezuelan population, whose plight the EU wishes to alleviate," without yet detailing the exact scope of the additional EU sanctions.[17] So far, the EU with Regulation (EU) 2017/2063 has already legislated an arms embargo and the prohibition on equipment, which might be used for internal repression, targeting also respective auxiliary services, as well as an asset freeze and prohibitions that no funds or economic resources shall be made available to or for the benefit of certain persons.[18] From the EU statements, it can be inferred that as a minimum it is to be expected that the list of persons subject to the asset freeze will be expanded.

IMPLICATIONS

The new sanctions targeting the Government of Venezuela may have significant effects for U.S. and non-U.S. companies. First, the novel features of the debt-related provisions, including restrictions on debt owed *to* rather than *by* PdVSA, may require firms to reconfigure their compliance strategies. For example, the purpose of covered transactions or the parties' relationship to the Government of Venezuela may not be readily apparent to financial institutions, who may, as a result, wish to supplement transaction

screening with compliance certifications from their customers. Foreign financial institutions must be wary as well. If a foreign bank obscures the purpose of a transaction in order for a U.S. bank to accept the transaction, the foreign bank could be held liable for "causing" a violation of U.S. sanctions.[19]

Furthermore, these additional sanctions, coupled with the prominence of state-owned enterprises in the Venezuelan economy, will further discourage U.S. companies from engaging in business in Venezuela. Companies that do or have done business in Venezuela already face significant challenges securing payment from state-owned entities, such as PdVSA. Not only does PdVSA lack the funding to pay outstanding debts but prior sanctions and OFAC-issued interpretative guidance have limited the ability of all parties to rely on debt financing.[20] Cutting off PdVSA's ability to use the sale of state-owned equities and accounts receivable financing to raise funds will make it more challenging to set acceptable payment terms for ongoing work in Venezuela. When no viable payment options remain, U.S. businesses will likely stop doing business with companies like PdVSA. In this way, the U.S. Venezuela-related sanctions may ultimately incur the same collateral costs that would have come from blacklisting PdVSA, even though these measures were intended to avoid this outcome.

Despite having this potential unintended consequence, the escalating sanctions targeting Venezuela have not yet had their intended effect on the Maduro regime. Although the Trump administration and the EU called for "free and fair" elections and the disbanding of the Venezuelan Constituent Assembly when announcing new sanctions last year, the Constituent Assembly certified the reelection of President Maduro in an election the Trump administration characterized as "neither free nor fair." [21] It is unclear whether the addition of these new prohibitions will be sufficient to achieve the desired outcome in Venezuela.

[1] E.O. 13835 (May 21, 2018), *available at* https://www.treasury.gov/resource-center/sanctions/Programs/Documents/venezuela_eo_13835.pdf.

[2] Statement from President Donald J. Trump on the Maduro Regime in Venezuela (May 21, 2018), *available at* <https://www.whitehouse.gov/briefings-statements/statement-president-donald-j-trump-maduro-regime-venezuela/>.

[3] OFAC FAQs at Question 512, *available at* https://www.treasury.gov/resource-center/faqs/Sanctions/Pages/faq_other.aspx#venezuela.

[4] E.O. 13835 § 2(d).

[5] E.O. 13835 § 1(a)(i).

[6] OFAC FAQs at Question 511, *available at* https://www.treasury.gov/resource-center/faqs/Sanctions/Pages/faq_other.aspx#venezuela.

[7] *Id.* at Question 419, indicating that payment terms for goods provided and services rendered are debt subject to applicable sanctions.

GIBSON DUNN

- [8] E.O 13835 § 1(a)(ii).
- [9] *Cf.* Directive 2 (as amended on Sept. 29, 2017) under Executive Order 13662, https://www.treasury.gov/resource-center/sanctions/Programs/Documents/eo13662_directive2_20170929.pdf.
- [10] E.O. 13808 (Aug. 24, 2017) ("EO"), *available at* <https://www.treasury.gov/resource-center/sanctions/Programs/Documents/13808.pdf>.
- [11] *Cf.* E.O. 13808 § 1(a)(i)-(ii).
- [12] E.O 13835 § 1(a)(iii).
- [13] OFAC FAQs at Question 511, *available at* https://www.treasury.gov/resource-center/faqs/Sanctions/Pages/faq_other.aspx#venezuela.
- [14] *Cf.* E.O. 13808 § 1(a)(ii).
- [15] *Cf.* E.O. 13808 § 1(b).
- [16] General License 2, *available at* https://www.treasury.gov/resource-center/sanctions/Programs/Documents/venezuela_g12.pdf.
- [17] Venezuela: Council adopts conclusions, *available at* <http://www.consilium.europa.eu/en/press/press-releases/2018/05/28/venezuela-council-adopts-conclusions/>.
- [18] Regulation (EU) 2017/2063, *available at* <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32017R2063&from=EN>.
- [19] E.O 13835 § 2(a); *see e.g.*, OFAC (July 20, 2017), *available at* https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170727_transtel.pdf,
- [20] Clifford Krauss, *ConocoPhillips Wins \$2 Billion Ruling over Venezuelan Seizure*, (Apr. 25, 2018) NY Times, *available at* <https://www.nytimes.com/2018/04/25/business/energy-environment/conocophillips-venezuela-ruling.html>.
- [21] Statement by the Press Secretary on New Financial Sanctions on Venezuela (Aug. 25, 2017), *available at* <https://www.whitehouse.gov/briefings-statements/statement-press-secretary-new-financial-sanctions-venezuela/>; Declaration by the High Representative on behalf of the EU on the presidential and regional elections in Venezuela *available at* <http://www.consilium.europa.eu/en/press/press-releases/2018/05/22/declaration-by-the-high-representative-on-behalf-of-the-eu-on-the-presidential-and-regional-elections-in-venezuela/>.

GIBSON DUNN



The following Gibson Dunn lawyers assisted in preparing this client update: R.L. Pratt, Judith Alison Lee, Adam Smith, Stephanie Connor and Richard Roeder.

Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding the above developments. Please contact the Gibson Dunn lawyer with whom you usually work, the authors, or any of the following leaders and members of the firm's International Trade Group:

United States:

Judith Alison Lee - Co-Chair, International Trade Practice, Washington, D.C. (+1 202-887-3591, jalee@gibsondunn.com)

Ronald Kirk - Co-Chair, International Trade Practice, Dallas (+1 214-698-3295, rkirk@gibsondunn.com)

Jose W. Fernandez - New York (+1 212-351-2376, jfernandez@gibsondunn.com)

Marcellus A. McRae - Los Angeles (+1 213-229-7675, mmcrae@gibsondunn.com)

Adam M. Smith - Washington, D.C. (+1 202-887-3547, asmith@gibsondunn.com)

Christopher T. Timura - Washington, D.C. (+1 202-887-3690, ctimura@gibsondunn.com)

Ben K. Belair - Washington, D.C. (+1 202-887-3743, bbelair@gibsondunn.com)

Courtney M. Brown - Washington, D.C. (+1 202-955-8685, cmbrown@gibsondunn.com)

Laura R. Cole - Washington, D.C. (+1 202-887-3787, lcole@gibsondunn.com)

Stephanie L. Connor - Washington, D.C. (+1 202-955-8586, sconnor@gibsondunn.com)

Helen L. Galloway - Los Angeles (+1 213-229-7342, hgalloway@gibsondunn.com)

William Hart - Washington, D.C. (+1 202-887-3706, whart@gibsondunn.com)

Henry C. Phillips - Washington, D.C. (+1 202-955-8535, hphillips@gibsondunn.com)

R.L. Pratt - Washington, D.C. (+1 202-887-3785, rpratt@gibsondunn.com)

Scott R. Toussaint - Palo Alto (+1 650-849-5320, stoussaint@gibsondunn.com)

Europe:

Peter Alexiadis - Brussels (+32 2 554 72 00, palexiadis@gibsondunn.com)

Attila Borsos - Brussels (+32 2 554 72 10, aborsos@gibsondunn.com)

Patrick Doris - London (+44 (0)207 071 4276, pdoris@gibsondunn.com)

Penny Madden - London (+44 (0)20 7071 4226, pmadden@gibsondunn.com)

Benno Schwarz - Munich (+49 89 189 33 110, bschwarz@gibsondunn.com)

Michael Walther - Munich (+49 89 189 33-180, mwalther@gibsondunn.com)

Mark Handley - London (+44 (0)207 071 4277, mhandley@gibsondunn.com)

Richard W. Roeder - Munich (+49 89 189 33-160, rroeder@gibsondunn.com)

© 2018 Gibson, Dunn & Crutcher LLP

Attorney Advertising: The enclosed materials have been prepared for general informational purposes only and are not intended as legal advice.