

January 31, 2019

VENEZUELA UPDATE: THE TRUMP ADMINISTRATION IMPOSES OIL SANCTIONS TO EFFECT REGIME CHANGE

To Our Clients and Friends:

On January 28, 2019, amid mounting tensions between Washington and Caracas, the Trump Administration imposed the most stringent sanctions to date on Venezuela by designating the state-owned oil company Petroleos de Venezuela, S.A. (“PdVSA”) on the Specially Designated Nationals and Blocked Persons (“SDN”) List administered by the U.S. Treasury Department’s Office of Foreign Assets Control (“OFAC”).^[1] This measure is especially noteworthy because it targets not just the most significant actor in Venezuela’s oil-dependent economy but also an entity that is very closely tied to the United States – owning U.S. assets, employing thousands of U.S. workers and providing 500,000 barrels of oil per day to the United States. By virtue of being added to the SDN List, all of PdVSA’s property and interests in property that are subject to U.S. jurisdiction are frozen and U.S. persons are, except as otherwise authorized by general or specific OFAC license, generally prohibited from engaging in transactions with PdVSA and its majority-owned subsidiaries.

This was a sprawling action, including not just the designation of a major, multi-billion dollar company, but also the issuance by OFAC of eight new General Licenses (“GLs”). The interpretation of some of the language in the GLs will require OFAC to issue additional Frequently Asked Questions (“FAQs”) beyond the one published to date.

As a policy matter, the primary driver behind the decision to designate PdVSA appears to have been a desire on the part of the United States to prevent the looting of state assets by the regime of current Venezuelan President Nicolás Maduro and to facilitate a change in control of Venezuela’s government. The designation comes just days after the Trump administration declared President Maduro’s recent re-election illegitimate and recognized Juan Guaidó, the head of Venezuela’s National Assembly, as the country’s interim leader.^[2] According to Secretary of State Mike Pompeo, the new sanctions on PdVSA “will prevent Maduro and other corrupt actors from further enriching themselves at the expense of the long-suffering Venezuelan people. It will also preserve the core pillar of Venezuela’s national assets for the people and a democratically elected government.”^[3] Treasury Secretary Steven Mnuchin similarly stressed that U.S. sanctions are by design reversible, and raised the possibility that PdVSA could in the future be de-listed.^[4] In that sense, the measures announced this week may best be viewed as a form of protective measure designed to safeguard Venezuelan state assets—for example, by placing them in blocked accounts—until they can be delivered to a non-Maduro government for use in the re-building of Venezuela’s shattered economy.

Overview of New Sanctions

The designation of PdVSA represents an extension of existing U.S. sanctions policy toward Venezuela, which for the last several years has been implemented in a series of steadily expanding sanctions targeting both President Maduro’s inner circle and sources of financing for the Venezuelan state. Up to this point, those measures have generally been narrow and incremental. For example, during the past 12 months, OFAC has issued a warning about transacting in Venezuela’s new cyber currency^[5] and imposed sectoral sanctions on certain debt and equity of the Government of Venezuela.^[6] The most recent step, which laid the groundwork for the designation of PdVSA, came on November 1, 2018, when President Trump issued Executive Order 13850, imposing sanctions on persons who operate in the gold sector of the Venezuelan economy, who engage in corruption involving Venezuelan government projects and programs, or who facilitate such activities.^[7] Crucially, Executive Order 13850 grants the Secretary of the Treasury discretion to extend these sanctions to any other sector of the Venezuelan economy he deems appropriate.^[8] That is the authority that Secretary Mnuchin employed this week to determine that persons operating in Venezuela’s oil sector may be subject to sanctions and on that basis designated PdVSA.^[9]

Through this designation, and except as otherwise authorized in any of several general licenses described below, the United States government has frozen all PdVSA property and interests in property that are in the United States, that later come into the United States, and that are within the possession and control of U.S. persons worldwide. By operation of OFAC’s “50 Percent Rule,” any property or interest in property that is owned 50 percent or more by PdVSA is also deemed to be blocked.^[10] Accordingly, U.S. persons can no longer deal with PdVSA’s majority-owned subsidiaries without OFAC authorization.

General Licenses

In connection with these sanctions, OFAC issued eight new GLs that will enable many U.S. persons to continue temporarily engaging with PdVSA and its affiliated entities, either to wind down their operations or to continue other kinds of engagement with PdVSA for specified periods of time. This approach is consistent with OFAC’s recent past practice of issuing strong and broad sanctions that are then calibrated through the issuance of general licenses and FAQs. While OFAC has not yet issued FAQs that will further construe the scope of these licenses, the structure of these licenses suggest an attempt by OFAC to incrementally redirect PdVSA revenue streams away from the Maduro government and Maduro’s associates while maintaining the value and viability of PdVSA and its U.S. subsidiaries PDV Holding, Inc. (“PDVH”) and CITGO Holding, Inc. (“CITGO”).

In moving to sanction a state asset like PdVSA, OFAC appears to be following the playbook it developed in Iraq and Libya in an effort to secure and preserve state assets from the grasp of a dictator. In 2011, OFAC employed sanctions to secure Libyan state assets just as Muammar Gaddafi was about to launch his forces on the opposition in Benghazi. In 1990, OFAC took similar action with respect to Kuwait after Iraq invaded the state in 1990. In both cases, OFAC froze core state assets as a “protective” measure and then de-listed the assets once the threat had been definitively removed. The challenge in Venezuela is that PdVSA is much bigger and far more intertwined in the United States, giving rise to potential

domestic collateral consequences in the United States that were far more limited in the case of Libya and Kuwait.

Authorizations that expire on February 27, 2019

GL 12(b) is a wind-down license and authorizes, until February 27, 2019, all transactions and activities ordinarily incident and necessary to an ordered termination of involvement in operations, contracts, or other agreements, including the importation into the U.S. of goods, services, or technology, involving PdVSA or any entity in which PdVSA owns a 50 percent or greater interest.

Authorizations that expire on March 29, 2019

GL 11 is a maintenance and wind down license and authorizes, until March 29, 2019, U.S. person employees and contractors of any non-U.S. entities except those non-U.S. entities located in Venezuela and the United States (“Certain Non-U.S. Entities”), to engage in all transactions and activities that are ordinarily incident and necessary to maintain or wind down operations, contracts or agreements involving PdVSA or any entity in which PdVSA owns a 50 percent or greater interest. This license additionally authorizes U.S. financial institutions to reject (rather than block and freeze) fund transfers involving both (i) PdVSA or any entity in which PdVSA owns a 50 percent or greater interest, and (ii) Certain Non-U.S. Entities, provided that neither the originator nor the beneficiary is a U.S. person and the funds are not destined for a blocked account on the books of a U.S. person. For reasons that are unclear, this License specifically excludes U.S. person employees and contractors of non-U.S. entities located in the United States from its authorization, and it appears that multinational corporations with a business presence in the United States whose employees and contractors are supporting PdVSA and its subsidiaries now require specific licensing from OFAC to continue doing so.

Authorizations that expire on April 28, 2019

GL 12(a) is a wind down license and authorizes, until April 28, 2019, all transactions and activities ordinarily incident and necessary to the purchase and importation into the United States of petroleum and petroleum products from PdVSA and/or from any entity in which PdVSA owns a 50 percent or greater interest. However, all payments for these products to or for the benefit of PdVSA or other blocked persons must be made into a blocked, interest-bearing account located in the United States. OFAC likely issued this license to ensure that U.S. persons have sufficient time to switch to alternate sources of these products and to try to avoid any short term supply shocks to the price of these products in the United States that an immediate cessation of these imports would have otherwise caused.

GL 7(b) authorizes, until April 28, 2019, all transactions and activities by PDVH, CITGO, and any of their subsidiaries that are ordinarily incident and necessary to the purchase and importation of petroleum and petroleum products from PdVSA or from any entity in which PdVSA owns a 50 percent or greater interest. This license is not styled as a wind down license, but as a license with a specific expiration. From a policy perspective, this is likely an effort by the Trump administration to allow PDVH and CITGO, which are now blocked persons, to complete delivery of currently scheduled imports from PdVSA to U.S. refiners without disrupting U.S. oil prices, but then pause any new orders of Venezuelan crude until the Maduro regime is replaced. Like General License 12(a), General License

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7(b) and 7(a)(see below) require that any payments made by PDVH and CITGO for these transactions to PdVSA and its subsidiaries be made into blocked U.S. accounts.

Activities that must be complete by July 27, 2019

GL 7(a) authorizes, until July 27, 2019, all activities with respect to PDVH, CITGO, and their subsidiaries, where the only PdVSA entities involved are these entities and their subsidiaries. Notably, however, OFAC makes clear in GL 7(d)(1) that its license does not extend to authorizing PDVH, CITGO, or any other U.S. persons supporting them, to export or reexport any goods, services, or technology to PdVSA in the context of other transactions authorized by the license.

GL 8 authorizes, until July 27, 2019, five named corporations to engage in all transactions and activities ordinarily incident and necessary to operations in Venezuela involving PdVSA or any entity in which PdVSA owns a 50 percent or greater interest. Notably, this is not styled as a wind down license, which suggests that the U.S. government's policy will be to allow U.S. multinational companies to continue supporting PdVSA's oil production and maintaining PdVSA's general viability as a future asset of the Venezuelan people and any transitional government.

GL 13 authorizes, until July 27, 2019, any transactions that would otherwise be prohibited (except payments to or for the benefit of a blocked person, which must be placed into a blocked account) involving PdVSA and Nynas AB or any of Nynas AB's subsidiaries.

General Licenses with No Expiration

GL 9 authorizes U.S. persons to continue engaging in any dealings in debt (including certain listed bonds, promissory notes, and other receivables) in which PdVSA owns a 50 percent or greater interest, provided that the debt was issued prior to August 25, 2017 and that any divestment or transfer of any U.S. person holdings are to a non-U.S. person. General License 9 effectively bifurcates a prior-issued OFAC license, General License 3, which is now replaced with General License 3A. General License 9 now continues OFAC's authorization for trade in debt issued by PdVSA and by PDVH, CITGO, and Nynas AB. General License 3A continues to authorize secondary market trade in listed bonds issued by the Government of Venezuela and other U.S. entities it owns and controls prior to August 25, 2017.

GL 10 authorizes U.S. persons in Venezuela to purchase refined petroleum products for personal, commercial or humanitarian uses from PdVSA or from any entity in which PdVSA owns a 50 percent or greater interest. This authorization does not, however, extend to any commercial resale, transfer, exportation or reexportation of these products.

GL 14 authorizes U.S. persons to engage in all transactions that are for the conduct of official business of the United States government by employees, grantees or contractors.

Implications and Opportunities

In addition to being one of the largest companies ever designated by OFAC, PdVSA is also more deeply interconnected with the United States than any previously designated entity. While OFAC's recent

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experiences with sanctions involving the Russian oligarch Oleg Deripaska and his holdings (including Rusal, En+ Group and JSC EuroSibEnergo) were complex, we expect that U.S. refiners' historical reliance on crude imports from PdVSA and the direct sanctioning of a major U.S. person refiner and distributor (CITGO) will present OFAC with many new, unintended collateral effects to work through. PdVSA currently sells more than 500,000 barrels of oil a day to the United States,[11] and through its subsidiary CITGO owns several refineries along the U.S. Gulf Coast that employ hundreds of Americans.[12] Accordingly, severing ties between PdVSA, its subsidiaries, both U.S. and non-U.S., and other U.S. persons is an unusually complex undertaking, in connection with which additional FAQs and guidance from OFAC will almost certainly be required.

However, with this complexity comes opportunity. In the past, OFAC has issued FAQs and new GLs to help manage the unintended consequences of its sanctions designations. In our experience, specific outreach to OFAC on these consequences can help prompt and shape the issuance of FAQs and GLs that can further clarify what activities are and are not specifically authorized. Moreover, and especially given the strong U.S. policy interests in enabling a rapid, peaceful transfer of power in Venezuela and in preserving PdVSA's continued viability as a revenue source, we believe that OFAC will be receptive to applications for specific licenses for transactions that can be shown to support both of these policy objectives. In the interim, and especially given the economic reach of PdVSA and its subsidiaries in Venezuela, the United States, and throughout the region, those continuing to do business with Venezuela's energy sector and in the many ancillary businesses, products and services that support it should take due care to identify any potential connection to PdVSA and U.S. persons that may require OFAC authorization.

[1] Press Release, *Treasury Sanctions Venezuela's State-Owned Oil Company Petroleos de Venezuela, S.A.*, U.S. Dep't of Treasury (Jan. 28, 2019), <https://home.treasury.gov/news/press-releases/sm594>.

[2] See, e.g., Ana Vanessa Herrero, *After U.S. Backs Juan Guaidó as Venezuela's Leader, Maduro Cuts Ties*, N.Y. Times (Jan. 23, 2019), <https://www.nytimes.com/2019/01/23/world/americas/venezuela-protests-guaido-maduro.html>.

[3] Press Statement, *Sanctions Against PDVSA and Venezuela Oil Sector*, U.S. Dep't of State (Jan 28, 2019), <https://www.state.gov/secretary/remarks/2019/01/288623.htm>.

[4] See Press Release, *Treasury Sanctions Venezuela's State-Owned Oil Company Petroleos de Venezuela, S.A.*, U.S. Dep't of Treasury (Jan. 28, 2019), <https://home.treasury.gov/news/press-releases/sm594>.

[5] OFAC, FAQ No. 566 (Mar. 19, 2018), https://www.treasury.gov/resource-center/faqs/Sanctions/Pages/faq_other.aspx#566.

[6] Exec. Order No. 13835, 83 Fed. Reg. 24001 (May 21, 2018).

- [7] Exec. Order No. 13850, 83 Fed. Reg. 55243 (Nov. 1, 2018).
- [8] Exec. Order No. 13850, 83 Fed. Reg. 55243 (Nov. 1, 2018). OFAC has emphasized, however, that it intends to interpret these potentially sweeping authorities narrowly. For example, OFAC has stressed that these measures are not meant to target legitimate transactions involving the Venezuelan gold sector, or any other sector that might be targeted in the future. OFAC, FAQ No. 629 (Nov. 1, 2018), https://www.treasury.gov/resource-center/faqs/Sanctions/Pages/faq_other.aspx#629. Rather, OFAC has indicated that it intends to sanction only transactions in targeted sectors that feature some added element of wrongdoing, such as “dishonest or fraudulent conduct” or transactions whose purpose or effect is to “misappropriate[e] Venezuelan resources . . . for personal, professional, or political gain.” *Id.*
- [9] Press Release, *Treasury Sanctions Venezuela’s State-Owned Oil Company Petroleos de Venezuela, S.A.*, U.S. Dep’t of Treasury (Jan. 28, 2019), <https://home.treasury.gov/news/press-releases/sm594>.
- [10] *See generally* OFAC FAQ Nos. 398-402 (Aug. 13, 2014), https://www.treasury.gov/resource-center/faqs/sanctions/pages/faq_general.aspx (describing the mechanics of OFAC’s Fifty Percent Rule).
- [11] Matthew Lee & Deb Riechmann, *US Hits Venezuela with Oil Sanctions to Pressure Maduro*, Associated Press (Jan. 28, 2019), <https://www.apnews.com/dbc0e01d010d41dba3576393c47c860e>.
- [12] Steven Mufson, *Trump Administration Announces Sanctions Targeting Venezuela’s Oil Industry*, Wash. Post (Jan. 28, 2019), https://www.washingtonpost.com/national/health-science/trump-administration-announces-sanctions-targeting-venezuelas-oil-industry/2019/01/28/4f4470c2-233a-11e9-90cd-dedb0c92dc17_story.html; Saleha Mohsin & Jennifer Epstein, *Trump Slaps De-Facto Oil Ban on Venezuela*, Bloomberg (Jan. 28, 2019), <https://www.bloomberg.com/news/articles/2019-01-28/trump-sanctions-venezuela-oil-company-pdvsa-rubio-announces>.



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