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## WHAT'S INSIDE



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# VENEZUELA: PROSPECTS FOR RESTRUCTURING SOVEREIGN DEBT AND REBUILDING A NATIONAL ECONOMY AGAINST THE BACKDROP OF A FAILING STATE[1]

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## OVERVIEW OF THE CRISIS

For the last several years, Venezuela has been facing an unprecedented crisis on a truly tragic scale. It has been first and foremost a grave humanitarian crisis, with untold suffering on the part of the Venezuelan people resulting from widespread malnutrition, growing poverty, the spread of otherwise preventable diseases such as malaria, and a breakdown of Venezuela's health care system.[2] In response to the breakdown in Venezuelan society in recent years, approximately five million or more Venezuelans have voted with their feet, fleeing Venezuela and seeking refuge in neighboring countries in Latin America and the Caribbean, such as in Colombia, Peru, Chile, Ecuador, Argentina, and Brazil. This outward migration of Venezuelans has, in turn, caused refugee crises in some of these neighboring countries and has led to tensions, for instance, between Colombia and Venezuela along their common border.

This humanitarian crisis in its different dimensions has been compounded by the arrival of the COVID-19 pandemic in Venezuela and its subsequent adverse impact on the Venezuelan people and Venezuelan society generally. Venezuela entered the COVID crisis from a very weak position, given that its healthcare system pre-COVID was already under substantial strain, if not in a state of complete dysfunction. Nonetheless, even as the human suffering of the Venezuelan people appears to have continued unabated over the last year, the COVID crisis has seemingly allowed the Venezuelan regime led by Nicolas Maduro to further consolidate its hold on power, given the strictures of a lockdown that was imposed by the government in response to the pandemic.

Beyond this humanitarian crisis, Venezuela is also facing a major financial and economic crisis. By many different indicators, the Venezuelan economy is currently in a state of virtual collapse, with the economy estimated to have contracted by approximately 65 percent between 2013-2019, according to the International Monetary Fund.[3] As many observers have noted, the contraction of the Venezuelan economy is even greater than the

[1] This article is adapted (and updated) from the author's article that was published in a Venezuelan law review, *La Revista Venezolana de Legislación y Jurisprudencia* (Venezuelan Journal of Legislation and Jurisprudence) (RVLJ), as part of a special tribute issue to prominent Venezuelan lawyer James O. Rodner. The RVLJ article contains a complete set of footnotes and, accordingly, should be referred to for sources of authority in this article. The RVLJ article was posted on the Harvard Law School Bankruptcy Roundtable blog (July 7, 2020) as well as on the Oxford Business Law Blog (July 20, 2020). The full RVLJ article can be found at http://www.kargmanassociates.com/RVLJ_S.Kargman_Venezuela_Debt_Restructuring(FINAL2020).pdf and/or on the HLS or Oxford blogs.

The author expresses gratitude to the editors for the special tribute issue of RVLJ, Professor Edison Lucio Varela Cáceres and Professor María Candelaria Domínguez Guillén, for their unwavering and generous support in bringing my RVLJ article to fruition. The author also gratefully acknowledges, first, the invaluable and constructive comments of Venezuelan lawyers James O. Rodner (Rodner, Martinez & Asociados), Rodolfo Belloso (LEC Abogados), and Roland Pettersson (D'Empaire) with respect to the author's earlier writings on the Venezuelan debt situation, and, second, the extremely thoughtful and helpful comments by Jonathan Koh, Professor Christoph Paulus, and Jorge Piedrahita on certain matters discussed in this article. (Of course, the usual disclaimers apply: namely, any errors in this article or in the author's earlier writings on Venezuela remain the sole responsibility of the author, and these individuals offered their comments strictly in their individual capacities.)

[2] An IMF blog described the situation as follows: "Since the beginning of the crisis, living conditions have severely deteriorated for Venezuela's 31 million inhabitants. Extreme poverty rose from 10 percent of the population in 2014 to 85 percent in 2018. And severe shortages of food and medicines continue to plague the population." See IMF Blog, November 21, 2019, "For Venezuela's Neighbors, Mass Migration Brings Economic Costs and Benefits," available at https://blogs.imf.org/2019/11/21/for-venezuelas-neighbors-mass-migration-brings-economic-costs-and-benefits/ (last visited on March 28, 2021).

[3] *Id.*

severe contraction experienced by the US during the Great Depression.

The Venezuelan economy was believed to have suffered a major contraction in 2019 and 2020 and is projected to suffer a further contraction in 2021. According to the IMF, the Venezuelan economy experienced a 35% decline in GDP in 2019, and, as of last October, the IMF was projecting that GDP would decline by 25% for 2020. In its latest set of forecasts for the global economy released in early April, the IMF has projected that the Venezuelan economy would shrink by a further 10% in 2021, although a recent forecast from Credit Suisse was more optimistic and projects growth of 4% for 2021.

Among the many major economic and financial woes that Venezuela is facing, it is suffering from serious hyperinflation, a deeply devalued currency, high unemployment, and dwindling foreign exchange reserves. Venezuela is also facing an unsustainable debt burden with outstanding debt that is believed to exceed one hundred fifty billion dollars.

## PROSPECTS FOR VENEZUELAN DEBT RESTRUCTURING

In light of Venezuela's precarious societal and financial/economic situation and Nicolás Maduro's regime appearing to remain firmly in control politically, it may seem premature to contemplate the possibility of a national restructuring of Venezuelan debt in the near term. In fact, several observers have characterized Venezuela as a "failing," if not "failed," state, and thus the prospects for a debt restructuring in that context may seem chimerical at best.

Yet, it was just under two years ago that there seemed to be some optimism regarding the prospects for a debt restructuring or at least there seemed to be some momentum in that direction. At that time, both the Juan Guaidó-led "interim" government and the largest grouping of Venezuelan bondholders sketched out their respective visions of the key principles that could guide any eventual Venezuelan debt restructuring.

Since then, however, the Maduro regime has tightened its grip on power. This was reflected in the December 2020 elections for the National Assembly (the "NA") which gave the Maduro-aligned forces control of that legislative body. However, the elections were boycotted and widely criticized and condemned by the opposition, the US government, and other observers who considered the elections to be flawed and not meeting basic standards of electoral fairness. For their part, the opposition forces seemed to have lost some momentum and political cohesiveness, and the leadership of Guaidó has come under some challenge or criticism from certain quarters within the opposition.

US government policy toward Venezuela under the Trump administration — namely, a tough sanctions regime vis-à-vis the Venezuelan government and its leaders as part of a policy of "maximum pressure" against the Venezuelan government — clearly did not achieve its goal of regime change, with the Maduro regime still remaining in power. Nonetheless, US sanctions have placed substantial economic pressure on the Venezuelan government, and, yet, the Maduro regime has developed ways to continue to hold on to power. For instance, the Maduro regime has sought to mitigate the impact of US sanctions through trading with countries such as Turkey and Iran and by pursuing other strategies. The Maduro regime has also undertaken other steps to keep certain parts of the economy functioning by loosening its control of the economy, such as by allowing greater use of the US dollar as a medium of exchange in the economy given that the Venezuelan currency, the bolivar, has become essentially worthless.

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## SOME KEY EVENTS UNDER CHAVEZ AND MADURO*

**1998** - Hugo Chavez is elected president; launches 'Bolivarian Revolution' with new constitution; socialist and populist policies funded by high oil prices.

**2001** - Chavez passes laws aimed at redistributing land and wealth; concern grows re concentration of economic and political power.

**2002** – Armed forces rebel over stand-off between government and state oil monopoly. Chavez is taken into military custody, but interim government collapses and he returns to office.

**2004** – Opposition parties boycott election; parties loyal to Chavez dominate.

**2006** – Chavez signs $3bn arms deal with Russia; wins third term with 63% of the vote.

**2007** – Nationalization of key energy and telecommunications companies approved by parliament. US companies Exxon Mobil and ConocoPhilips refuse to hand over majority control; Venezuelan government expropriates them.

**2008** - Venezuela and Russia sign oil & gas accord.

**2009** – Voter referendum ends term limits for elected officials, allowing Chavez to run again in 2012.

**2010** - Chavez devalues currency to boost revenue from oil exports after economy shrank 5.8% in Q4 2009; in Sept parliamentary elections, opposition makes significant gains.

**2012** – Gov't extends price controls on basic goods to battle inflation; Chavez wins 4th term; withdraws from ICSID.

**2013** – After a long battle with cancer, Chavez dies in March and his hand-picked successor, Nicolás Maduro, is elected president by a contested margin.

**2014** – Public spending cut as oil prices reach 4-yr low; at least 28 die in suppression of anti-government protests.

**2015** - Opposition coalition wins two-thirds majority in parliament; 16-year control by Socialist Party ends.

**2016** - Hundreds of thousands protest in Caracas, blaming Maduro for economic crisis and calling for his removal; recall referendum leads to impasse with the National Electoral Council.

**2017** – Major protests and violent confrontations continue; a controversial election is convened by Maduro to replace the National Assembly.

**2018** – National elections are held amid confusion, date changes, accusations of irregularities, and low voter turnout. The opposition contests official victory of Maduro.

**2019** – Maduro is inaugurated in January for a second 6-year term in the face of strident objections from the opposition and the US, UK, EU and others. National Assembly opposition leader Juan Guaidó declares interim presidency recognized by 50+ countries. On 30 April, a group of several dozen military personnel and civilians join Guaidó in an uprising against Maduro, however, an "uneasy peace" is established the same day. Norway facilitates mediation efforts; the US imposes sanctions.

**2020** – Opposition parties boycott legislative elections, losing seats in the National Assembly; the Guaido movement wanes. Failed coup attempt is labeled "Bay of Piglets."

**2021** – Economic and humanitarian crisis worsens with widespread shortages, hyperinflation, hunger, COVID-19. A national "Loyalty ID" is implemented and connected to vaccination. New clashes occur along the Columbian border; Maduro blames Colombian oligarchy.

**Note: This timeline was compiled by the editors as a supplement to the article.*

With US sanctions effectively limiting imports into Venezuela and otherwise putting constraints on the Venezuelan economy by limiting which parties Venezuela may trade with and how it conducts international financial transactions, it is widely believed that US sanctions may have contributed to further suffering among the Venezuelan people. To be sure, though, there was widespread misery and suffering in Venezuela even before the imposition of US sanctions due, in no small part, to the mismanagement by the Chavez-Maduro governments of the economy and the pervasive corruption in Venezuela's government and its agencies.

It remains to be seen what new policies, if any, the new Biden administration will pursue in dealing with the situation in Venezuela. For example, will the new Administration simply continue the existing US sanctions regime vis-à-vis Venezuela or will it modify that sanctions regime? Will the Biden administration encourage or support a diplomatic approach to the resolution of Venezuela's political stalemate which might have as its ultimate goal the establishment of a post-Maduro transition government in Venezuela? The formation of such a transition government was the ostensible aim of a since-terminated Norway-led mediation process in the last few years that involved the Venezuelan opposition and the Maduro regime.

As I first wrote over two years ago in a four-part article in *The International Economy* (*TIE*) in which I discussed what I called Venezuela's "debt restructuring conundrum,"[4] Venezuela urgently needed a debt restructuring at that time, and yet such a debt restructuring was unlikely to occur then or in the foreseeable future as long as the Maduro regime remained in power. That was true particularly in light of US sanctions and their impact on the ability of US creditors to interact with the Maduro regime and to obtain new debt securities from the Maduro regime as part of any bond exchange that would be an integral feature of any eventual Venezuelan debt restructuring.

When I wrote the article in *TIE* mentioned above, I argued that the more time which passed before Venezuela began a debt restructuring process, the more difficult it would be to reach a satisfactory debt restructuring outcome for the country and its creditors, especially since at the time of that article the Venezuelan economy in general, and the oil industry in particular, were already in a state of fairly serious decline. I also noted that the risk of litigation against the Republic and/or PDVSA (with the possibility of judgments eating into the assets of the Republic and/or PDVSA) would only increase with the passage of time. The bottom line, I argued, was that the continued decline of the economy and the increased risk of litigation would mean that there would ultimately be fewer resources available to a Venezuelan government to work out a satisfactory restructuring with its creditors,

Since the first installment of the article in *TIE* was published in December 2018 – and even since the fourth installment of the article was published in December 2019 – the deterioration of the Venezuelan economy and the Venezuelan oil industry has continued apace. Moreover, the litigation against the Republic and PDVSA has taken on a life of its own, with many lawsuits having already been filed and many still pending in the US. Thus, in light of these developments and in keeping with the thesis in my earlier article, the prospects for a debt restructuring would appear to have become even more problematic than they were just a few short years ago.

Nonetheless, the prospects for a debt restructuring could improve if the political situation were somehow to change in the not-too-distant future, but particularly if that were to happen before the Venezuelan economy and the structures of Venezuelan society completely collapse. For example, if the Maduro regime were dislodged from power by a new government with more democratic leanings, or if a transition regime were able to successfully combine elements from both the opposition and the Maduro regime, then it might be possible to contemplate a Venezuelan debt restructuring. Of course, at this point, those are not immediately foreseeable scenarios, although the possibility that the landscape could shift unexpectedly cannot be ruled out.

With the state of Venezuelan affairs as they now are, time may be fairly short for the political and economic situation in Venezuela to turn around significantly in a reasonable period of time. It should be noted that the longer it takes to reach the point where Venezuela and its creditors could even contemplate negotiating a potential debt restructuring, the steeper the "haircut" creditors would likely need to accept in any such eventual debt restructuring. The prevailing pessimism among investors and creditors about the prospects for a Venezuelan debt restructuring and a satisfactory creditor recovery has been reflected in the deeply distressed trading prices of Republic and PDVSA debt on the secondary market.

As of the end of March 2021, Republic bonds were reported to be trading generally in the range of 10-11 cents on the dollar and PDVSA bonds are reported to

[4] See author's four-part article in *The International Economy* (TIE) from Fall 2018-Fall 2019: S. Kargman, "Venezuela Needs Debt Restructuring," *TIE*, Fall 2018, pp. 58-61; S. Kargman, "Venezuelan Debt Conundrum," *TIE*, Spring 2019, pp. 38-41; S. Kargman, "Oh! What a Tangled Web," *TIE*, Summer 2019, pp. 50-55; and S. Kargman, "Shrinking Pie," *TIE*, Fall 2019, pp. 52-56. For other articles by the author on the Venezuelan debt situation (apart from the RVLJ article cited in footnote 1), see S. Kargman, "Venezuela's Debt Restructuring: Predictable Uncertainties" (Parts 1 &2), *Global Restructuring Review* (June 10-11, 2020), and S. Kargman, "Thoughts on the Possible Restructuring of Venezuelan Debt," Interview for Newsletter of LEC Abogados (Caracas, Venezuela) (January 2020).

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be trading in the range of 4-5 cents on the dollar.[5] Even so, Venezuelan debt is apparently very thinly traded on the secondary market for various reasons, including the role of US sanctions (which, among other things, have prohibited US persons from trading Venezuelan debt with other US persons, thereby severely crimping liquidity in Venezuelan debt).

In short, it is truly a race against time for Venezuela to successfully undertake a debt restructuring and economic recovery program. Crucially, if too much more time elapses before this happens, Venezuela's economy and finances, not to mention Venezuelan society, may reach a point where they are effectively beyond repair and remediation. In other words, if Venezuela does not reverse its downward trajectory in a reasonable period of time, it sadly risks eventually becoming the ultimate nightmare scenario of economists, development experts, financiers, and humanitarians worldwide: namely, another failed state with a truly dysfunctional economy of the type that has been seen in some developing countries in recent decades (e.g., Zimbabwe under Mugabe, as some have suggested).

So far, the Maduro regime has been able to slog through and hold onto power despite the grave situation now facing the Venezuelan people. However, even if the regime can maintain control in the near term (and thus, at least for the time being, prevent the emergence of a new government), it remains to be seen whether it will be able to continue to do so in the longer term, particularly if Venezuela continues on what in the last few years has seemed like an inexorable downward spiral.

## MAJOR LEGAL AND POLICY ISSUES IN DEBT RESTRUCTURING SCENARIOS

Yet, if and when Venezuela eventually does reach the stage where it is in a position to restructure its debt, it will face a myriad of challenges associated with a comprehensive debt restructuring and any associated economic recovery/reconstruction program. At that point, all relevant stakeholders will need to hit the ground running in the race against the clock discussed above. This is why it is so important that such stakeholders think through clearly and in detail the types of issues they may encounter in such an undertaking.

The following discussion highlights some of the key legal and policy challenges that Venezuela and its stakeholders may face when undertaking a comprehensive debt restructuring and economic recovery/reconstruction program.

Venezuela has a staggering debt load estimated to be $150 billion or more. This consists of debt from both the Republic of Venezuela and its state-owned oil company, PDVSA. Unlike a typical sovereign debt restructuring, a Venezuelan debt restructuring would involve not simply one obligor but rather two separate (albeit closely related) obligors. Venezuela, through the Republic and PDVSA, owes debt to an extremely broad range of creditors, including bondholders, bilateral creditors, suppliers/trade creditors, arbitration award holders, holders of claims for blocked funds (e.g., airlines, etc.), and promissory noteholders, among others. (While there is actually a third Venezuelan government-connected obligor, Venezuela's state-owned electricity utility, Electricidad de Caracas (ELECAR), the amount of ELECAR's outstanding debt pales in comparison to the amount of outstanding debt of the Republic and PDVSA.)

For Venezuela to eventually recover economically, it will need to undertake a comprehensive debt restructuring so that post-restructuring it will not have the unsustainable debt burden that it is now carrying—a debt burden that is so unsustainable that Venezuela is currently in default on most of its outstanding debt. Any eventual Venezuelan debt restructuring, which is not likely to take place until a new government is in place, promises to be unlike any recent sovereign debt restructurings.

There are many factors that could potentially complicate a Venezuelan debt restructuring. In the first place, there is the large number and wide range of creditors which may pose significant challenges for creditor coordination, a crucial element in any complex debt restructuring. In addition, there is the broad diversity of creditor interests which could well lead to major intercreditor tensions and/or conflicts among and between the various creditor constituencies. Furthermore, the collapsed state of the Venezuelan economy could, among things, limit the resources available to support a Venezuelan debt restructuring, and thus in turn likely increase the sacrifice that stakeholders would have to make as part of any eventual restructuring deal.

Moreover, Venezuela's largest bilateral creditors, China and Russia, could play wild card roles in any eventual debt restructuring. China and Russia became such significant creditors to Venezuela when they entered into so-called loan-for-oil (or oil-for-loan) transactions with Venezuela. Under these transactions, China and Russia extended loans to Venezuela, and, in return, Venezuela agreed to repay those loans in shipments of oil to China and Russia.

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5 It should be noted that there are two PDVSA bonds that are outliers: the PDVSA 8 ½% 2020 bonds are reported to be trading in the range of 23-26 cents on the dollar (due to the special pledge of Citgo Holding stock), and the PDVSA 6% 2022 bonds are reported to be trading in the range of 2.75-3.75 cents on the dollar (due to the controversy surrounding these bonds which are sometimes referred to pejoratively as the "hunger bonds" since they were said to prioritize the payment of debt service over meeting the dire social needs of the Venezuelan people). (This pricing information was kindly furnished by Russ Dallen of Caracas Capital.)

Thus, for a broad range of reasons including those discussed above, any eventual Venezuelan debt restructuring promises to be extraordinarily messy and complicated — probably much more so than any of the sovereign debt restructurings of recent years.

### Applying Standard Restructuring Tools and Techniques

Nevertheless, classic restructuring tools and techniques that have been used in other sovereign debt restructurings could potentially be applied to resolve Venezuela's debt crisis. For example, there may well need to be debt forgiveness by Venezuela's creditors with the aim of leaving Venezuela with a sustainable debt burden post-restructuring. Alternatively, at least at the outset of any restructuring exercise, there might be short-term reschedulings of debt service payments on Venezuela's outstanding debt (which are known as debt reprofilings in the sovereign context) in order to relieve payment pressures on Venezuela in the near term.

For those creditors and other stakeholders who believe that Venezuela is fundamentally facing more of a liquidity crisis as opposed to a solvency crisis in light of Venezuela's vast oil reserves (reputed to be the largest in the world), such debt reprofilings, where debt service payments are pushed out a few years, may well be a more palatable option than outright reductions in principal through debt forgiveness. Moreover, as with many sovereign debt restructurings, any eventual Venezuelan debt restructuring may involve adjustments in the interest rates or coupons on Venezuela's outstanding debt so that Venezuela's debt service payments become more manageable or sustainable.

As has been suggested by various observers, in view of the significance of oil to the overall Venezuelan economy, Venezuela may end up including so-called oil warrants as part of any debt restructuring package. Other oil-producing countries have used oil or other commodity-based warrants in past sovereign debt restructurings. Basically, with oil warrants, creditors would be entitled to an additional payout on their restructured debt above and beyond the required debt service payments if and when the price of oil exceeds a certain baseline projection for the price of oil.

Oil warrants are one type of so-called "value recovery instruments" that have been used in previous sovereign debt restructurings.[6] GDP warrants, which were used in the Greek debt restructuring in 2012 and the Argentine debt restructurings in 2005 and 2010, represent another type of value recovery instrument where creditors would make an additional recovery if a country's GDP exceeded certain baseline projections for the country's GDP performance.

### Applying Less Commonly Used Sovereign Debt Restructuring Tools and Techniques

In addition to the foregoing debt restructuring techniques, there may be other techniques employed in any Venezuelan debt restructuring that have not been employed in other recent sovereign debt restructurings in the last decade or longer.

#### *1980s-Style Debt-for-Equity Swaps Updated for the Current Environment*

A future Venezuelan debt restructuring might, for instance, involve debt-for-equity swaps or conversions. Debt-for-equity swaps in corporate debt restructurings are not uncommon and represent a fairly straightforward way for a corporate debtor to deleverage its balance sheet, but debt-for-equity swaps work much differently in the sovereign context than in the corporate context. Obviously, a national government, in contrast to private corporations, does not issue shares in itself, and thus the sovereign itself does not have any equity in itself that it can offer as part of a debt-for-equity swap.

Rather, the sovereign government in question needs to identify companies in the debtor country where a creditor/foreign investor could effectively swap debt for shares in those companies identified by the government. Not infrequently in prior sovereign debt restructurings, the companies which sovereigns identified for purposes of a debt-for-equity swap were companies that were formerly state-owned enterprises but that were subsequently privatized (and thus may have had equity or stock available for purchase/exchange by the creditor/foreign investor).

At its most basic level, in a debt-for-equity swap in the sovereign context, the "commercial debt owed by a sovereign debtor to private creditors is purchased by an investor in the secondary market and is then converted into an equity investment in the debtor country."[7] However, in previous sovereign debt-for-equity swaps, there was often an intermediate step in this process: the foreign investor exchanged the debt it had purchased on the secondary market into the local currency of the sovereign debtor, and it was that local currency that was then used by the foreign investor to purchase the equity in the local company.

[6] For a discussion of value recovery instruments (including so-called GDP warrants and oil warrants), see generally Lee Buchheit, Guillaume Chabert, Chanda DeLong, and Jeromin Zettelmeyer, "How to Restructure Sovereign Debt: Lessons from Four Decades," p. 14-15 (Peterson Institute for International Economics, Working Paper 19-8, May 2019).

[7] *See*, *e.g.*, Sailesh S. Radha, "Debt-Equity Swaps: Structure, Impacts and Perspectives," p. 3 (available at http://borealisga.com/wp-content/uploads/2015/10/International-Debt-Restructuring.pdf) (last visited on March 28, 2021). For a slightly more elaborate explanation of a sovereign debt-for-equity swap, *see* id. at pp. 3-4 ("In a debt-equity swap, external debt of a developing country is converted into local currency funding for equity investment int that developing country…." (internal citation omitted).

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These types of debt-for-equity exchanges were not uncommon in Latin American debt restructurings of the mid-1980s through the mid-1990s, when a number of Latin American countries were undergoing major sovereign debt restructurings in connection with the debt crisis of that era.[8] In roughly the same time frame, a number of Latin American countries experienced a wave of privatizations of their state-owned enterprises, and these privatizations provided a source of equity that national governments could then effectively exchange for debt instruments as part of the debt-for-equity swaps in their respective sovereign debt restructurings.

Indeed, Venezuela adopted a debt-equity swap program in the mid-1980s and applied it through the early 1990s. Under that program, the foreign investor first purchased Venezuelan sovereign debt at a discount from a creditor (such as a commercial bank) in the secondary market. Next, the foreign investor converted that debt into bolivars, which was the legal tender of Venezuela, at a predetermined rate set by the Venezuelan government. Finally, the foreign investor used those bolivars to purchase equity in a company that was operating in Venezuela, but the foreign investor could do so only in certain types of companies as was specified in guidelines published at the time by the Venezuelan government.

In the context of an eventual Venezuelan restructuring in the coming years, it is possible that a new Venezuelan government might consider whether there are any state-owned enterprises that would be suitable candidates for privatization. For example, there are a number of major Venezuelan companies in various industries—e.g., cement, aluminum, steel, auto parts, etc.—that are now Venezuelan state-owned companies, but these same companies were previously privately owned companies until they were expropriated by the Chavez regime in the period from roughly 2007 onward.

Many of these companies have now fallen on hard times as state-owned enterprises, and thus, as a policy matter, a new Venezuelan government might wish to consider whether privatization would provide a reliable pathway for improving the performance and profitability of these companies. If some of these now state-owned enterprises were to be privatized by a new Venezuelan government, that might create the conditions for establishing a new program of debt-for-equity swaps as one avenue for Venezuela to restructure its outstanding debt. Under such a program, Venezuela's creditors could exchange their debt for shares in what would be the then-newly privatized enterprises.

Nonetheless, if a new Venezuelan government initiated a new debt-for-equity swap program, the Venezuelan debt held by the creditor/investor would need to be exchanged directly for shares in the private companies such as newly privatized enterprises. Such a debt-for-equity swap would take place without what was previously an important intermediate step in this process: namely, exchanging the debt in question for the local currency (e.g., Venezuelan bolivars) and then using the local currency to purchase equity in the privatized enterprise.

The bolivar-based approach for Venezuelan debt-for-equity swaps in the 1980s-1990s would not work under present circumstances due to the serious hyperinflation that currently exists in Venezuela. With a deeply devalued bolivar as a result of the existing hyperinflation in Venezuela, a company participating in the debt-for-equity swap would basically have no use for bolivars, except perhaps to make an immediate payment of an invoice denominated in bolivars.

(The Venezuelan government has replaced and/or devalued its currency several times since the 1980s, while continuing to call its currency some form of a Venezuelan bolivar. The hyperinflation that has existed in Venezuela in the recent past has had the effect of rendering the form of bolivar that was then in use fairly worthless as a currency. For example, the Venezuelan government replaced its currency most recently in 2018 when it replaced the bolívar fuerte (Bs.F.) with the bolívar soberano (Bs.S); the exchange ratio for the replacement was 1 Bs.S to 100,000 Bs.F. Nonetheless, the introduction of the new currency in 2018 has not halted the continued decline of the Venezuelan economy, nor has it eliminated the hyperinflation that has afflicted the Venezuelan economy for the last several years.)

Finally, it should be noted that, when implementing a debt-for-equity swap along the lines discussed above, a new government in Venezuela would certainly want to ensure that it had conducted a proper financial

8 For a discussion of debt-for-equity swaps as used in the Latin American debt crisis, *see, e.g.*, "Debt-Equity Swaps Draw Latin Criticisms," *The New York Times,* January 2, 1989 (noting various objections by Latin American government to debt-for-equity swap programs); Daniel H. Cole, "Debt-Equity Conversions, Debt-for-Nature Swaps, and the Continuing World Debt Crisis," (1992) (articles by Maurer Faculty, Paper 690; John K. Shubin and Daniel J. Gibby, "The Promotion of Debt-Equity Swaps in Latin America: A Survey of the Regulatory Regimes and the International Policy Framework," *Inter-American Law Review*, Vol. 20:1 (1988); Stephen M. Wallenstein and James R. Silkenat, "Investment Funds and Debt-Equity Swaps: Broadening the Base of New Financial Tool," *Fordham International Law* Journal, Vol. 12:8 (1988).

valuation of the enterprise in which the foreign investor/creditor would receive equity in exchange for its debt. That would be the only way the new government could ensure that it is receiving fair value for the equity that it is giving to the foreign investor/creditor in exchange for the debt that is being tendered, and thus the only way that the government could ensure that it would not be shortchanging itself or the Venezuelan people.

***New Venezuela-Specific Debt-for-Equity Swaps Based on Oil (and Other Mineral) Development Rights***

Another type of debt-for-equity swap, where the equity component of the swap is broadly construed, may also be relevant for those parties developing any eventual Venezuelan restructuring plan. Yet, unlike the 1980s-style debt-for-equity swaps discussed above, the equity component of the swap would not relate to shares in a corporation but rather would relate to development rights in Venezuela's oil reserves which notably are widely reputed to be the largest oil reserves in the world.

It is conceivable that in a future Venezuelan debt restructuring some of the creditors, such as perhaps creditors who are players in the oil industry (e.g., oil field service operators, etc.), may be willing to forgive a portion of their debt in exchange for, say, a certain quantity of development rights in previously undeveloped Venezuelan oil fields. There are, in fact, many trade creditors/suppliers such as oil field service operators which are owed large amounts of money by Venezuela, and these trade creditors/suppliers represent an important constituency in the overall Venezuelan creditor body.

For those creditors undertaking such an exchange, they would need to be knowledgeable about the oil business, particularly with respect to matters concerning oil exploration and development, including the crucially important technical and commercial aspects thereof. The value that the creditors will be receiving as part of this exchange would be dependent on their ability to produce oil from the development rights that they have been given and would also be dependent on the price of oil at that point in time when these creditors would be trying to sell the oil that they have developed.

These creditors will need to reach a view as to how difficult it will be to develop the oil reserves in question as well as how long it will take to develop such reserves. These creditors will also need to develop a view regarding the future price of oil, although that in and of itself is a matter that is inherently subject to a considerable amount of uncertainty given the significant fluctuations in the price of oil over time (especially in view of oil's boom and bust cycles).

A new Venezuelan government would also need to understand the value of oil development rights that it would grant the creditor/investor participating in the debt-for-equity swap. This question is inherently complex and will require experts to undertake a financial valuation of the development rights in question. Otherwise, a new Venezuelan government might be opening itself up to criticism that it was giving away the Venezuelan national patrimony at "bargain basement" prices.

For the present discussion, structuring such debt-for-equity swaps, including defining the precise mechanics for such swaps, will require Venezuelan law expertise to ensure that such swap transactions would work properly under Venezuelan law. Venezuelan lawyers will also need to work through various Venezuelan legal questions that might arise. For instance, what type of entity under Venezuelan law could be granted development rights by the Venezuelan government as part of a debt-for-equity swap of the type described above?

Venezuelan lawyers will also need to consider whether such development rights could be granted by the Venezuelan government to a single creditor/corporation (particularly if it is a foreign creditor/corporation), as opposed to those development rights that may be granted to a joint venture between a foreign investor and a Venezuelan government-owned entity such as PDVSA. In the past, the joint venture path has been the usual, and indeed the only legally permissible, way by which a foreign entity could invest in Venezuela's oil sector under Venezuelan law, and in fact the foreign investor's interest was even capped by law so that the Venezuelan state-owned entities such as PDVSA held greater than a 50% interest in the hydrocarbon joint venture. It was often the case that as a matter of practice the foreign investor in the joint venture would hold a 40% interest in such joint ventures with PDVSA and/or another state-owned entity holding the remaining 60% interest.

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The same idea of debt-for-equity swaps where the equity component consists of development rights in oil could also be applied to development rights for other minerals found in Venezuela which, like oil, also exist in some abundance in Venezuela. For example, Venezuela is richly endowed with other minerals such as iron, gold, coal, bauxite, nickel, titanium, zinc, copper, and diamonds. Thus, the development rights for these other minerals might represent an attractive option for creditors to Venezuela who are willing to exchange debt for equity in the form of development rights in the types of minerals mentioned above but who may not be specifically interested in receiving development rights in oil reserves.

**Potential Challenges to Prior Debt Issuances and/or Other Debt Obligations**

If and when a new government comes to power in Venezuela, it will need to decide which of its outstanding debt obligations it plans to honor. There may be certain debt issuances which the new government considers to be invalid or possibly even illegitimate.

A new government may wish to consider whether any debt claims against the Venezuelan government or PDVSA were incurred as a result of corruption and/or fraud and therefore would not need to be recognized as part of any debt restructuring. Indeed, the so-called interim government led by Juan Guaidó, in a statement in July 2019 setting forth guidelines for any eventual restructuring negotiations, referred specifically to "claims *procured or tainted by demands of corruption* allegedly committed by officials in the Chavez/Maduro regimes…." (emphasis added).[9]

In that vein, Venezuelan lawyers will need to work with accountants and others in considering which debt claims are appropriate, and which should be recognized for purposes of repayment versus those debt claims that are fraudulent and/or otherwise considered to be invalid or illegitimate. As outlined in the guidelines from Venezuela's so-called interim government discussed above, that will be an important element of the claims reconciliation process (which is itself an integral part of the overall debt restructuring process) since the claims reconciliation process essentially separates out those claims that will be included as part of the restructuring process and those claims that will basically be thrown out and not included in the restructuring process.

Separately, there may be very few available targets of opportunity for a new Venezuelan government in the future (or even for the Guaidó-led opposition at the present) as to which potential challenges can be mounted to the validity of Venezuelan debt that has been publicly issued by the Republic or PDVSA in the last few years, particularly since 2016 when the Maduro regime seemingly began to encroach upon the powers of the opposition-controlled National Assembly. Specifically, the Republic has apparently not issued any foreign law-governed public debt in the period from 2016 to the present.

But this was not the case with PDVSA. In 2016, as part of a so-called distressed exchange offer to replace PDVSA bonds due to mature in 2017 but that were then on the verge of default, PDVSA issued new bonds commonly known as the PDVSA 2020 bonds since they had a final maturity date of 2020. (The new bonds also bore a coupon of 8 ½ percent.)

In one challenge already brought by the alternate PDVSA Board of Directors (controlled by the Guaidó-led "interim" government), the PDVSA board filed a lawsuit in the US District Court for the Southern District of New York seeking to invalidate what are known as the PDVSA 2020 bonds and the related governing documentation, including an all-important pledge of Citgo Holding stock (discussed below). The lawsuit was ultimately unsuccessful in the District Court, but that ruling has since been appealed to the US Court of Appeals for the Second Circuit. Thus, with the appeal in that case still pending as of late March, the eventual outcome of this case—and thus whether or not the challenge to the validity of the PDVSA 2020 bonds and the governing documentation (including the pledge of Citgo Holding stock) will ultimately be successful—remains uncertain for the time being.

The PDVSA 2020 bonds had an unusual feature in that they were secured by a pledge of a 50.1 percent interest in the shares of Citgo Holding, the holding company for Citgo Petroleum Corporation (Citgo), which is almost universally considered to be one of PDVSA's crown jewels in light of Citgo's valuable refinery and pipeline assets in the US. Thus, since late October 2019 when PDVSA defaulted on payment of the PDVSA 2020 bonds, PDVSA has been at risk of losing control of Citgo to the PDVSA 2020 bondholders.

If that were to occur, that would be a major blow to PDVSA and to the so-called interim government led by Juan Guaidó since Citgo represents one of the few assets that the interim government putatively controls. This flows from the US government's decision to recognize both the Guaidó-led interim government and the decision by US courts to recognize the validity of the alternate PDVSA Board of Directors which is aligned with the interim government and the opposition.

Nonetheless, apart from any court proceedings related to the PDVSA 2020 bonds, the holders of the PDVSA 2020 bonds have been prevented from executing on

[9] *See* Office of the Special Attorney General of the Bolivarian Republic of Venezuela, "Guidelines for the Renegotiation of the Chavez/Maduro Era Legacy Public External Debt," July 1, 2019, p. 2. See also Colby Smith and Robin Wigglesworth, "Venezuela's Opposition Sets Out Debt Restructuring Plans," *Financial Times*, July 3, 2019.

their pledge of Citgo Holdings shares due to actions taken by the Office of Foreign Assets Control (OFAC) of the US Treasury Department. Essentially, dating to 2019 and now extending to July 2021, the holders of the PDVSA 2020 bonds have been prevented from exercising on their collateral and selling the shares of Citgo Holding unless and until they obtain a special "license" from OFAC to do so, but OFAC has not yet granted such a license to those bondholders.

In the lawsuit it brought in the US District Court for the Southern District of New York, PDVSA and certain affiliates challenged the validity of the PDVSA 2020 bonds since the security arrangement underlying the bond issuance—namely, the pledge of CITGO Holding stock to the PDVSA 2020 bondholders—was not approved by Venezuela's National Assembly. Essentially, the argument by the alternate PDVSA board was that since the granting of the security interest to the PDVSA 2020 bondholders was, to use the term of art under the Venezuelan constitution, a "national public interest contract," it should have been approved by the National Assembly as required by Article 150 of the Venezuelan constitution.  Furthermore, the PDVSA-related parties in the case also called attention to the to the fact that the Venezuelan National Assembly had passed a resolution disapproving the transaction that PDVSA was proposing to enter into involving the PDVSA 2020 bonds and the related pledge of shares of Citgo Holding stock.

In an October 2020 decision, Judge Katherine Polk Failla of the US District Court for the Southern District of New York rejected the challenge of the alternate PDVSA Board to the validity of the PDVSA 2020 bonds and the governing bond transaction documentation.  The District Court's decision was based on the grounds that ultimately, among other factors that the District Court considered relevant in establishing sufficient contacts between the PDVSA 2020 bonds and the governing documentation and New York (and thus establishing the applicability of New York law), the bonds and the related transaction documentation were by their terms governed by New York law.  Thus, in the District Court's view, the considerations of Venezuelan law raised by the PDVSA-related parties as a basis for challenging the validity of the PDVSA 2020 bonds and the governing bond documentation were not relevant to the Court's disposition of the case.

However, as noted above, shortly after the District Court decision was handed down last fall, the PDVSA-related parties in the case appealed the District Court's ruling to the US Court of Appeals for the Second Circuit, and, as of late March, the appeal was still pending in the Second Circuit. Among other matters, the appeal raises issues concerning conflict of laws; i.e., what jurisdiction's law is the relevant applicable law for


resolving the dispute, New York law or Venezuelan law. The case has also raised issues as to what deference should be accorded to the acts of a foreign state (e.g., resolutions of the National Assembly) under the "act of state" doctrine and what deference should be accorded to a foreign government's interpretation of its own laws under principles of international comity.

On a different front, there is a possibility that a new Venezuelan government might also raise issues of "odious debt" as a basis for challenging the validity or legitimacy of certain debt issuances by Venezuela.[10] While commentators often refer to the "odious debt *doctrine*," it is not, strictly speaking, a legal doctrine in the traditional sense since it has not been formally recognized by courts of law or other tribunals.  Thus, the "odious debt" concept, if it were raised by a successor Venezuelan government in the course of a judicial proceeding, might not gain much, if any, traction in such a formal proceeding.  However, as more fully discussed below, if a successor Venezuela government were to raise the odious debt issue (whether or not it did so in court or simply in its public pronouncements ), and assuming that the new government had a sound basis for raising or invoking a claim of odious debt, it might put itself in a more advantageous position in any debt restructuring negotiations that the government was engaged in with the creditors putatively responsible for the odious debt.

In the Venezuelan context, odious debt might come into play if a new Venezuelan government could satisfy a three-part test in the standard formulation of the "odious debt doctrine" as set forth by Alexander Sack in his classic 1927 treatise on this subject.  Pursuant to that test as applied to the situation in Venezuela, a successor government in Venezuela would have to prove three elements.  The first element is that the loan transaction in question was not approved by the Venezuelan populace, and the second element is that the debt that Venezuela incurred was not for the benefit of the Venezuelan people.  The third element is that the creditors extending such loans knew that loans would not be used for the benefit of the Venezuelan people and also knew that the loans were not approved by the Venezuelan people.

10 *See, e.g.*, Robin Wigglesworth, "Venezuela Crisis Raises Talk of 'Odious Debt' Doctrine, *Financial Times*, September 11, 2017.

For example, a new Venezuelan government might raise odious debt claims regarding the validity or enforceability of debt incurred by the Chavez regime in connection with its arms purchases from Russia in the early 2000s. Specifically, such a claim might arise if such debt was incurred by the Venezuelan government to purchase arms for the Venezuelan military forces and those arms were not used for proper military purposes for the benefit of the Venezuelan people such as for defending against external foes but instead were used, for example, to repress the Venezuelan people. As part of the three-part test for odious debt discussed above, it would also need to be shown that the loans were not approved by the Venezuelan people and that the party extending the credit to Venezuela knew that was how the loan proceeds would be used and also knew that the loan was not approved by the Venezuelan people.

In the early 2000s, the Chavez regime incurred debt from the Russian government so that the Venezuelan government could purchase several billion dollars' worth of arms from Russia. Indeed, those arms purchases from Russia were considered a cornerstone of the then budding relationship in the early 2000s between the Chavez regime and the Putin-led Russian government, a relationship that allowed Russia to establish influence with a country in the geopolitical "backyard" of the United States.

Nonetheless, whether those arms transactions would actually give rise to valid odious debt claims would obviously involve a highly fact-specific inquiry. Among other areas of possible investigation, such an inquiry might well center on whether the military purchases were used for proper military purposes or, rather, for illegitimate purposes such as for repressing the Venezuelan people if and when, say, they opposed or demonstrated against the Chavez-Maduro regimes.

Such an inquiry would also have to examine whether the Russian government, as the putative lender in question, knew that was how its loans would be used and also knew that the loans were not approved by the Venezuelan people. To be sure, any such inquiry would also depend on the quality and probative value of any odious debt-related evidence adduced by the successor Venezuelan government.

Separately, a new Venezuelan government might raise odious debt claims if the previous governments under Chavez and Maduro issued debt only to divert the proceeds of such debt issuances from the national treasury into the pockets of government officials or other individuals for their private benefit (and the creditors knew that this represented a potential use of the loans they were providing and knew that such loans were not approved by the Venezuelan people). This might present a classic odious debt fact pattern or scenario in which the proceeds of a loan entered into by a government are not used for the betterment of its citizens but are instead used for the self-enrichment or self-aggrandizement of those ruling the country in question.

Since there have reportedly been massive diversions of funds from public coffers in Venezuela for the personal benefit of certain individuals who are or were part of the Chavez-Maduro regimes or were otherwise connected to these regimes, this leg of an odious debt inquiry might also be of considerable potential interest to any new successor Venezuelan government. Again, such a successor Venezuelan government would also have to adduce the relevant evidence showing that the loan proceeds were used for the personal benefit of those ruling the country and that the lenders knew that is how the loan proceeds would be used and knew that the loans were not approved by the Venezuelan people.

Whether or not Venezuela would ultimately prevail in a court of law if it raised an odious debt claim is very much open to question, particularly in view of the fact that the notion of odious debt, in the nearly 100 years since Alexander N. Sack first published his treatise on the "odious debt doctrine," has apparently never received the formal imprimatur of a court ruling. Further, in the view of some legal scholars, the "odious debt doctrine" has not risen to the level of custom in international law. Therefore, if a successor Venezuelan government decided to pursue an odious debt claim in court, its chances of success could hardly be guaranteed by any stretch of the imagination.

Importantly, though, the mere act by a new Venezuelan government of raising the odious debt issue (assuming, again, that a new Venezuelan government had some type of a valid basis for raising or invoking "odious debt") might improve Venezuela's negotiating position vis-à-vis the affected creditors since it might allow Venezuela to claim the moral high ground in its negotiations with the creditors in question and thereby potentially increase its leverage in such negotiations. Moreover, simply raising odious debt as a public issue might also carry some weight in the court of international public opinion among a range of stakeholders in the international system. Since sovereign debt restructurings (especially high-profile sovereign debt restructurings) often play out on an international stage, an odious debt claim by Venezuela might help Venezuela gain moral or political support from various international stakeholders. In turn, this might affect the dynamics of any actual negotiations between Venezuela and the creditors putatively connected to the "odious debt" in question.

Nonetheless, whenever a sovereign contemplates a challenge to the validity of debt it has issued or otherwise incurred (whether it does so on the basis of odious debt or on other grounds), it needs to take into account the potential costs and benefits of pursuing such a course of action. Assuming that the sovereign is successful in its quest to invalidate the debt in question, at what cost will it have achieved that benefit? For example, will the sovereign in any way be tarnishing its reputation in the credit or capital markets as a borrower that honors its contractual obligations, or will the sovereign's basis for challenging the validity of the debt in question be so compelling and persuasive that it will not suffer such a hit to its reputation?

Or, for instance, might the sovereign be able to achieve the objective it is seeking through other means, such as through attempting to negotiate a deep haircut on the outstanding debt in question? Of course, as noted above, the fact that a sovereign raises the odious debt issue, even if it does not seriously pursue the issue in court, may assist the sovereign in its effort to achieve such a deep haircut; i.e., merely raising the issue may potentially give a sovereign some leverage in debt restructuring negotiations.

## MAJOR LEGAL AND POLICY ISSUES IN AN ECONOMIC RECOVERY SCENARIO

If and when a new Venezuelan government comes to power, it will need to implement a multidimensional program to rebuild the Venezuelan economy. It will need to take several key programmatic initiatives, including reviving Venezuelan's oil industry, diversifying Venezuela's economy, and recovering billions of dollars of government assets that may have been diverted from government coffers.

### Economic Recovery—Reviving the Venezuelan Oil Industry

It is no secret that the Venezuelan oil industry has deteriorated in a major way in recent years, and its oil-producing infrastructure is currently viewed as being in a state of major disrepair and dysfunction due to many years of neglect and lack of capital investment.[11] Oil production has plummeted in recent years, going from a level of 2.5 million barrels per day as recently as 2016 to a level of approximately 750,000 barrels per day in the first half of 2019 or so, a depressed level of production that had not been seen in over fifteen years.[12] More recently, oil production has declined to half a million barrels by mid-2020[13] and less than a half-million barrels as of year-end 2020/January 2021. A projection in early January 2021 by S&P Global Platts energy reporting service stated that Venezuelan oil production might decline to approximately 300,000 barrels per day in 2021.[14] However, oil production in Venezuela has reportedly increased to over 500,000 barrels per day in the last two months. Venezuela was reported to have produced 538,000 barrels per day in February and 578,000 barrels per day in March (compared to 484,000 barrels per day in January), according to data from OPEC.

Whether or not this recent reported increase in production is sustainable over time and is indicative of a longer-term trend remains to be seen. It should be noted that Venezuela has also recently benefited from the strong rebound in global oil prices over the past few months.

Separately, the number of active operational oil rigs in Venezuela has declined sharply in recent years,[15] and there have been reports that as of August 2020 Venezuela had not a single rig that was operational.[16]

In light of the marked deterioration of the production capabilities of the Venezuelan oil industry over many years, it is widely acknowledged that Venezuela will need billions of dollars—perhaps even tens of billions of dollars, by some estimates—to restore its oil industry. Some of the necessary funding for this economic redevelopment generally may come from the international financial institutions, such as the World Bank (including its private sector arm, the International Finance Corporation (IFC)), the Inter-American Development Bank, and CAF (Development Bank of Latin America), as well as from national export credit agencies (ECAs) and national development finance institutions. Nonetheless, funding solely from those institutions may not be sufficient by itself.[17]

11 For a discussion of the state of Venezuela's oil industry and the industry's centrality to Venezuela's economy, *see, e.g.*, Steven T. Kargman, "Venezuelan Debt Conundrum," *The International Economy* (Spring 2019). *See also* Ruth Krivoy, "Venezuela: In a Hole, and Still Digging," *Emerging Markets Restructuring Journal* (Summer 2018), pp. 1-6.

12 Energy Information Administration (US Department of Energy), "Venezuelan Oil Production Falls to Lowest Level Since January 2003," May 20, 2019 (pointing out that "[t]he number of active oil rigs—an indicator of future oil production—also fell from nearly 70 rigs in the first quarter of 2016 to 24 rigs in the first quarter of 2019") (available at https://www.eia.gov/todayinenergy/detail.php?id=39532) (last visited on March 28, 2021).

13 See US Energy Information Administration, "Country Analysis Executive Summary: Venezuela," updated November 30, 2020, available at https://www.eia.gov/international/content/analysis/countries_long/Venezuela/venezuela_exe.pdf (last visited on March 28, 2021).

14 See, S&P Global Platts, "Commodities 2021: Venezuela's Oil Industry Expected to Deteriorate Further," Jan. 4, 2021 (available at https://www.spglobal.com/platts/en/market-insights/latest-news/oil/010421-commodities-2021-venezuelas-oil-industry-expected-to-deteriorate-further)(last visited on March 28, 2021).

15 See *supra* note 11.

16 See, e.g., "Venezuela's Rig Count Officially Falls To Zero," available at https://oilprice.com/Energy/Energy-General/Venezuelas-Rig-Count-Officially-Falls-To-Zero.html (last visited on March 28, 2021).

17 For a broader discussion of how the Venezuelan economy can recover in a post-Maduro regime scenario, *see, e.g.*, "The Day After: How Venezuela's Economy Can Recover from The Maduro Regime," *The Economist*, January 31, 2019 (a brief discussion of the so-called "morning-after plan" developed by Harvard professor Ricardo Hausmann, including the need for an infusion of approximately $60 billion from the international financial institutions including the IMF). *See also* Earl Anthony Wayne and Moises Rendon, "Planning for the Day After in Venezuela," Center for Strategic & International Studies (CSIS), March 28, 2019 (available at https://www.csis.org/analysis/planning-day-after-venezuela) (last visited on March 28, 2021).

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Rather, Venezuela may also be very dependent on investment from the private sector as well, including from foreign investors and foreign companies that would have an interest in reviving Venezuela's oil-producing capabilities on a profit-making basis. Of course, as a threshold matter, a new Venezuelan government would need to make certain that it would be comfortable with foreign investment playing such a major role in the redevelopment of Venezuela's oil industry. Further, in light of any potential political sensitivities surrounding this issue (i.e., questions that might be raised by Venezuelan politicians or citizens as to whether, as discussed above, the Venezuelan government would be "giving away" its national patrimony), a new government would undoubtedly want to ensure that the Venezuelan public supports such an approach.

To be sure, regardless of whether the necessary funding comes from the international financial institutions or the private sector or other financing sources, any new Venezuelan government would presumably want to ensure that any future oil exploration and development activities in Venezuela are undertaken a manner that is as environmentally sensitive and responsible as possible. A new Venezuelan government would also most likely need to be responsive in one way or another to global concerns about the role of fossil fuels in climate change and investor interest in ESG (environmental, social, and governance) matters.

In order to attract this type of investment, it is likely, though, that the current Venezuelan legal framework for foreign investment in general and foreign investment in the oil industry in particular will need to be reviewed to see whether that framework is adequate or robust enough to facilitate this new investment. Specifically, Venezuelan lawyers and policymakers will need to consider whether, in order to facilitate greater foreign investment in the Venezuelan oil industry, there will need to be changes to Venezuela's existing hydrocarbons law and/or its foreign investment law generally.

For example, in a joint venture context, Venezuelan policymakers will need to consider questions such as the following: Will the hydrocarbons law need to be revised in order to permit majority foreign ownership in joint ventures with PDVSA, something that is now prohibited by current law? And, as some commentators have argued, will Venezuela's current royalty rates need to be lowered in order to make Venezuela more competitive with other oil-producing countries in the region?[18]

As with any type of foreign investment that a new Venezuelan government will hope to attract, future foreign investors in the oil industry will want greater certainty in the contractual arrangements that they will enter into with Venezuelan government counterparties. This is particularly true in light of the spate of expropriations that took place under the Chavez regime, including expropriations that took place specifically in the oil industry.

A key element in providing such certainty would be to afford parties to the relevant contractual arrangements the possibility of resorting to international arbitration in a venue outside the host country jurisdiction when there is a dispute between the parties. The availability of international arbitration as a contractually agreed upon means of dispute resolution is often a sine qua non for foreign parties investing in an emerging market or developing country jurisdiction since foreign parties do not want to end up settling contractual disputes in the local courts in the host country jurisdiction.

Venezuela had previously been a party to the ICSID Convention under which international investment disputes between investors and States are handled by an arbitration tribunal under the auspices of the World Bank affiliate, ICSID (the International Centre for the Settlement of Investment Disputes). However, in 2012, Venezuela under the Chavez regime withdrew from (or, in the technical parlance, "denounced") the ICSID Convention. Significantly, this withdrawal or denunciation by the Venezuelan government did not affect cases against Venezuela that were then pending at ICSID.[19] There were a number of such cases that were then pending at ICSID, and several of them ultimately resulted in very sizeable judgments against Venezuela, such as an ICSID judgment against Venezuela that was awarded to ConocoPhillips in the original amount of $8.7 billion.[20]

Thus, if a new Venezuelan government aims to regain the trust and confidence of foreign investors (whether in the oil industry or in other sectors of the Venezuelan economy), it will certainly have to seriously consider rejoining the ICSID Convention.

### Economic Recovery—Diversifying Venezuela's Economy

As is well known, the Venezuelan economy is overwhelmingly dependent on a single commodity, namely oil. In years past, oil revenues have constituted a not insignificant part (approximately 25 percent) of Venezuela's GDP, funded a substantial part (approximately 50 percent) of Venezuela's national

18 Andres Guevara de la Vega and Carlos Bellorin, « ¿Por qué sí hace falta una Nueva Ley Orgánica de Hidrocarburos? (Why Do We Need a New Hydrocarbons Law ) », *Prodavinci*, February 27, 2019 (available at https://prodavinci.com/por-que-si-hace-falta-una-nueva-ley-organica-de-hidrocarburos-1/) (last visited on March 28, 2021).

19 Sergey Ripinsky, "Venezuela's Withdrawal From ICSID: What it Does and Does Not Achieve," *Investment Treaty News*, April 13, 2012 (International Institute for Sustainable Development) (available at https://www.iisd.org/itn/2012/04/13/venezuelas-withdrawal-from-icsid-what-it-does-and-does-not-achieve/.) (last visited on March 28, 2021).

20 That judgment was then apparently reduced to $8.5 billion. "World Bank Tribunal Lowers ConocoPhillips Award for Venezuela Expropriation: Document," *Reuters*, September 2, 2019.

budget, and generated a huge part (approximately 90-95 percent) of Venezuela's hard currency export earnings.

Yet, the Venezuelan economy was not always a "one-trick pony." Venezuela used to have a fairly productive manufacturing sector in industries such as auto parts, cement, steel, aluminum, and so forth, but notably that was when companies in those industries were privately owned. As noted above, it was essentially not until the expropriations of the Chavez regime in 2007 and thereafter that Venezuela's manufacturing sector seemed to fall into decline.[21]

While at least in the near to medium term oil will almost certainly play an important role in the future of the Venezuelan economy, any new government in Venezuela will need to consider whether it wishes to remain so heavily dependent on a single commodity such as oil (especially a commodity whose price is subject to such wild swings) or whether it wishes to diversify its economy so that there is greater balance in the economy between the oil and non-oil sectors as was previously the case in Venezuela.

Moreover, there could be an additional impetus—and indeed a global imperative—for Venezuela to pursue a strategy of economic diversification: specifically, the concern worldwide about climate change and in particular the major role of fossil fuels in contributing to carbon emissions. Obviously, global concern about these issues could lead to lower worldwide demand for fossil fuels going forward, and as a result, just as oil companies will face a vastly different business landscape in the coming years, oil-producing countries such as Venezuela will have to reckon with this new global reality as well.

A strategy of economic diversification is not guaranteed to succeed, or at least not to achieve success overnight or without encountering obstacles along the way, judging by the prior experience of other developing countries. Nonetheless, unlike a number of other developing and emerging market countries that have pursued strategies of economic diversification in the past, Venezuela at least has a model for what a more diversified economy would like, and that is basically the economy that existed prior to the Chavez-era expropriations.

In other words, for Venezuela, an economic diversification strategy might possess an element of "back to the future"—i.e., reviving some of the Venezuelan manufacturing industries that existed through the mid-2000s prior to the expropriations that took place in the ensuing years. Yet, a new Venezuelan government might want to carefully consider which of its prior manufacturing industries have the potential to be competitive in the coming years, so that it can then encourage investment in those particular industries rather than in industries that will not be competitive in the future.

However, policymakers in a new government will also need to consider whether there are any other new industries in which Venezuela in the future could enjoy a comparative advantage in the global economy. A new government should consider encouraging investment in any such new, promising industries.

A new Venezuelan government and its advisers will need to consider whether any changes in its legal and/or regulatory framework are necessary in order to encourage investment by foreign investors (but also by any potential Venezuelan investors) in non-oil sectors of the Venezuelan economy. For example, a new government might wish to consider whether the processes for granting permits for investments or granting work visas for foreign employees are too burdensome and/or time-consuming. Further, as mentioned above in connection with the discussion of attracting new investments in the Venezuelan oil industry, Venezuela's rejoining the ICSID Convention could provide foreign investors with additional comfort when investing in non-oil sectors in Venezuela.

### Asset Recovery

It is widely believed that billions of dollars—possibly tens of billions of dollars, if not more—have been improperly diverted from Venezuela's public coffers into the hands of individuals, including reportedly former or current government officials as well as individuals who are associates or relatives of government officials. According to various reports, PDVSA assets in particular have been a major target of opportunity for those Venezuelans seeking to misappropriate assets from Venezuela.

In the summer of 2018, the US Attorney's Office in Miami unveiled a major indictment of a number of Venezuelans who were allegedly engaged in money laundering involving more than a $1 billion, and at the same time the US Attorney's Office also froze real estate and other assets that were alleged to have been purchased with funds stolen from PDVSA. More recently, in March 2020, the US government issued indictments against Maduro and several high-ranking Venezuelan government officials, past and present, for their alleged involvement in drug trafficking, money laundering and so-called "narco-terrorism."

If the funds that have reportedly been misappropriated from Venezuela could ultimately be recovered, they could play an important role in providing funding to help with the rebuilding of the Venezuelan economy

[21] Jim Wyss, "Venezuelan Government Controls More Than 500 Businesses—and Most Are Losing Money," *Miami Herald*, March 14, 2017 (citing a report indicating that 70 percent of the 511 companies that are either wholly owned or partially owned by the Venezuelan government are losing money).

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and Venezuelan society more broadly. Thus, when any new government comes into power, it might be well advised to consider how it could undertake a broad-reaching asset recovery effort so that it can recapture these billions of dollars for the benefit of the Venezuelan people.[22]

A note of caution is certainly in order, since any asset recovery program could involve painstaking efforts over an extended period of time—possibly even over a period of a number of years—before the asset recovery efforts might bear significant (or perhaps even modest) results. Accordingly, as a matter of prudence and sound planning, any debt restructuring and/or economic recovery plan pursued by a new government should probably not be predicated on achieving a specific dollar amount of asset recoveries and obviously not on achieving such recoveries in a short period of time. Instead, whatever funds are recovered through such efforts might better be viewed essentially as an unexpected (but certainly most welcome) windfall.

## CONCLUSION

If and when a new government comes into power in Venezuela, it will have to address a broad array of monumental challenges with respect to both humanitarian/social issues and financial/economic issues. In terms of the financial/economic issues discussed in this article, a new government will have to make some fundamental decisions early on concerning what position it wants to take on major policy matters.

A new government will need to decide a range of issues such as whether it wants to support a program that privatizes state-owned enterprises, and whether it will want to diversify the Venezuelan economy so that it is not so heavily dependent on the oil industry. It will also have to decide whether it will welcome foreign investors who can play an important role in the revival of the Venezuelan economy, and whether it will support debt-for-equity exchanges that could transfer ownership stakes in newly privatized enterprises and/or its natural resources to foreign investors/creditors. Furthermore, depending on these policy choices, a new government will have to develop detailed plans and programs for implementing its overall policy objectives, and such plans and programs will have to be carefully analyzed for their conformity with relevant Venezuelan law. Finally, a new government will want to ensure that it has broad public support for the initiatives it is undertaking.

22 For an in-depth discussion of insolvency tools that may be used in asset recovery efforts, *see, e.g.*, Jean-Pierre Brun and Molly Silver, "Going for Broke Insolvency Tools to Support Cross-Border Asset Recovery in Corruption Cases" (World Bank, 2020) (available at https://star.worldbank.org/sites/star/files/going-for-broke.pdf) (last visited on March 28, 2021). For a discussion of a proposal for an IMF-administered trust fund for asset recovery for Venezuela (a so-called "Venezuela Asset Recovery Trust"), *see, e.g.*, Thomas W. Laryea, "Venezuela's Debt Resolution: Recover the Assets," *Financial Times (Alphaville)*, October 30, 2019.

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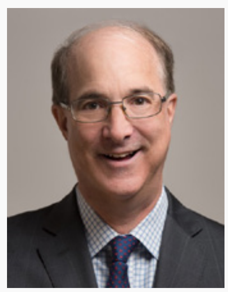

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