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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Venezuela Sanctions Boost Legal Risks For Energy Cos.

By **Keith Goldberg**

Law360, New York (September 1, 2017, 7:56 PM EDT) -- While tighter U.S. sanctions recently imposed on Venezuelan President Nicolás Maduro's regime largely spare the country's oil and gas sector, experts caution that new restrictions on Venezuelan debt deals could jeopardize ongoing development agreements between foreign energy companies and Venezuela and ultimately force them into litigation.

The sanctions imposed by President Donald Trump's Aug. 24 executive order and outlined by the U.S. Treasury Department's Office of Foreign Assets Control a day later still allow the import and export of crude oil between the U.S. and Petróleos de Venezuela SA, the state-owned oil company also known as PDVSA, as well as debt and equity transactions involving Citgo Holding Inc., PDVSA's U.S. refining arm, that don't involve any other part of the Venezuelan government.

However, the sanctions bar U.S. entities and persons from acquiring any new debt of PDVSA with a maturity over 90 days and new debt with any other Venezuelan government entity with a maturity over 30 days, as well as distributing dividends or profits to the government from entities it controls. Experts say the PDVSA debt restrictions could be contractual land mines for foreign energy companies that have partnered with PDVSA on major oil and gas development projects in Venezuela.

"These projects require very complex agreements," said María Eugenia Salazar Furiati, a Caracas-based partner at Baker McKenzie and a member of the firm's oil and gas and investment arbitration groups. "Companies must figure out how these contracts could be jeopardized by the sanctions."

Foreign energy companies that are potentially subject to the U.S. sanction regime — or simply don't want to get on the bad side of the U.S. government — must reconcile the new restrictions with the realities of working with a cash-strapped PDVSA that rarely pays its bills in a timely fashion, experts say.

"Extending the delay in payment terms could be looked at as being a letter of credit," said Tom Moore, who co-heads Mayer Brown LLP's global energy group. "It becomes more uncertain where your contractual terms are within the 90 days, but you know from practice that PDVSA may not pay within a year."

For oil field service firms that have tolerated PDVSA bending the payment terms of contracts in order to retain the business of one of the world's largest oil producers, experts say the new sanctions present a potential dilemma: At what point do they stop providing new services?

International oil producers that are in joint venture agreements with PDVSA on development projects face similar issues. Although they hold the minority stake in these agreements, Moore says many deals have been restructured to have the non-PDVSA partner front all the capital development costs with the expectation of being repaid with part of PDVSA's share of production revenues.

“It’d be hard to argue that this type of arrangement isn’t a loan, which could create real issues under the sanctions,” Moore said.

Even if there is no formal arrangement, Moore said that in many of these JVs, PDVSA essentially acts as the operator and marketer for the petroleum and pockets the proceeds from the sales, which are then distributed to its minority partners.

“What’s happening is the minority, non-Venezuela party is not getting paid, and the mixed company is developing from PDVSA oil and gas,” Moore said. “Again, you get into a difficult question: Does that constitute an extension of credit?”

While it's unlikely that OFAC would punish companies simply because PDVSA has breached its payment obligation, the agency could press them to be more aggressive in pursuing payment from PDVSA once the payment terms have expired, according to Mayer Brown international trade partner Simeon Kriesberg.

Experts say that places energy companies between a rock and a hard place: Risk a legal battle with PDVSA by pursuing breach of contract and expropriation claims or attempting to wriggle out of the contract, or run afoul of the U.S. sanctions regime.

“No doubt, it's a dilemma,” Mayer Brown international arbitration partner Mike Lennon said.

Expropriation claims likely mean taking PDVSA and Venezuela to international arbitration, which has proven to be a contentious, drawn-out affair for energy companies ever since former Venezuelan President Hugo Chávez nationalized the oil industry in 2007 and prompted most international energy companies to exit the country, with no guarantee of success.

Meanwhile, attempting to get out of contracts with PDVSA carries legal risks as well, according to Salazar Furiati.

“In case the law applicable to contracts executed by the affected companies and PDVSA is the Venezuelan law, PDVSA might argue a breach of contract in case the affected companies decide to step out of it,” Salazar Furiati said.

Experts say PDVSA and their foreign partners could try to stave off a legal confrontation through adjusting the terms of their JV or service agreements or even try to temporarily freeze the project they're partnering on, but that will have to be considered on a contract-by-contract basis.

“If sanctions are imposed and it prevents a party from performing the contract, we need to pay attention to what type of relief [the contract] would provide, if any relief,” said Stoel Rives LLP of counsel Anthony Girolami, whose practice focuses on energy transactions in Latin America.

OFAC is giving U.S. entities 30 days to wind down contracts related to new debt or equity from the Venezuelan government. Bracewell LLP white collar partner Jeff Vaden, who prosecuted sanctions cases

while serving as an assistant U.S. attorney in Houston, said that reflects the agency's understanding of the repercussions of sanctions on U.S. businesses and sensitivity to their concerns when rolling out the sanctions.

But collateral damage is unavoidable, Vaden said.

“The reality is, the sanctions are supposed to be a hardship, to prevent U.S. companies from doing business with entities on OFAC's list,” Vaden said.

That means energy companies whose deals with PDVSA could be imperiled by the new sanctions have a choice to make, according to Moore: Wait out the sanctions and hope they prompt a change in the Venezuelan political and business environment, or take the sanctions as a sign that the environment is untenable and look to get out as quickly as possible.

“Doing business with PDVSA has not been a picnic for some time now,” Kriesberg said. “But [the new sanction regime] certainly raises the ante because it imposes some direct liability exposure on U.S. persons if they extend credit or if they’re not seen as realistically holding PDVSA accountable.”

--Editing by Christine Chun and Sara Ziegler.

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