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Venezuela: A War of Principles or Just a Matter of Semantics?

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Synopsis

This article looks at the current critical situation in the Republic of Venezuela and focuses on its ongoing debt crisis. The core of the article analyses the guidelines published by the Guaido Administration (the currently recognised Government of Venezuela in several jurisdictions, including the UK and US), and the principles published by a creditor committee based in the US, that nucleates some institutional and retail investors. As can be seen from the analysis, these principles include some interesting points (the clash between debtor and creditors as to how to treat the debt, i.e. aggregate different claims against the central government and its state-owned enterprises or separate by distinguishing the debtor entity) and some others that would be difficult to implement (e.g. equal treatment, which cannot be put in practice due to some contractual or structural limitations). Probably it would have been more meaningful just to endorse and abide by the Principles for Stable Capital Flows and Fair Debt Restructuring, produced by the Institute of International Finance, which are the industry standard. More importantly, recent events might accelerate a run-to-the-courthouse but we should not lose sight at the pressing need to resolve the prevailing humanitarian crisis.

1. Introduction

The Bolivarian Republic of Venezuela ('Venezuela') is suffering an unprecedented humanitarian crisis.[1] One that is even more difficult to comprehend considering that the country sits on the biggest oil reserves in the world.[2] A combination of failed policies and corruption has pushed Venezuela into the abyss with constant electricity blackouts and shortages of the most essential goods (medicines, baby food, etc.). Moreover, its citizens are fleeing the country in staggering numbers.[3]

The interim government of Juan Guaido has attempted to regain control of the country and lead it into a democratic path that can guarantee essential liberties and re-establish order (and an economic sustainable path). In recent dramatic events, Guaido, the interim president of Venezuela, has been sworn as speaker once again of the National Assembly following a blockade preventing him from entering the building. The priority of the Guaido administration should be addressing the needs to the people of Venezuela and addressing the humanitarian crises.

It goes without saying that an IMF programme is required to stabilise the fragile Venezuelan economy which is in free-fall with an estimated inflation of 10,398% per year.[4] To put this plan in place, data and time is needed, but also access to new financing. The latter in turn screams for a comprehensive debt restructuring. Hopefully, all this will result in a flow of foreign direct investments and access to the international capital markets at standard market rates to rebuild the country.

Venezuela, its state-owned oil company (PdVSA) and the capital city's electric company (ELECAR) debt obligations are currently in default and total more than USD 155 billion[5] of principal and interest payments due on outstanding bonds. In view of the need for a debt restructuring exercise, the Guaido Administration and the creditors have recently published what should be the guiding principles of a possible restructuring. These are summarised and commented below.

2. Principles issued by the Guaido administration

On 1 July 2019, the office of the special attorney general of Venezuela published a document titled 'Guidelines

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1 Human Rights Watch, World Report 2019, available at https://www.hrw.org/world-report/2019/country-chapters/venezuela#16e9b9.

2 For some key figures on Venezuela's oil reserves, production and exports, see Organization of the Petroleum Exporting Countries (OPEC), *Venezuela Facts and Figures*, available at https://www.opec.org/opec_web/en/about_us/171.htm

3 See the United Nations High Commissioner for Refugees, *Venezuela Situation*, available at https://www.unhcr.org/venezuela-emergency.html.

4 Steve Hanke, 'Venezuela's Hyperinflation Drags on for a Near Record – 36 months', *Forbes*, 13 November 2019.

5 Mark A. Walker and Richard Cooper, 'Venezuela's Restructuring: A Path Forward', *Emerging Markets Restructuring Journal* (Cleary Gottlieb) 9 (Summer 2019).

for the Renegotiation of the Chavez/Maduro era Legacy Public External Debt' (the 'Guaido Guidelines').[6]

The Guaido Guidelines establish the policies that will guide the renegotiation of foreign currency-denominated private claims against Venezuela and its state owned enterprises. These guidelines are:

1. *Comprehensive Private Claims Renegotiation*: a restructuring will include all the foreign currency-denominated claims against the Venezuelan public sector (including, inter alia, claims related to unpaid supplier invoices and damage claims resulting from the expropriations and nationalisations carried out by the Chavez/Maduro regimes).
2. *Claim Reconciliation*: a reconciliation process under the auspices of an agent will take place to convert foreign currency-denominated claims into eligible claims, i.e. claims eligible to participate in the renegotiation. For this, the validity, legality and value of the claims will have to be determined. A memorandum detailing the guidelines for this process will be published in due course.
3. *Equal Treatment*: all reconciled claims will be eligible to participate in the renegotiation on equal terms with all other reconciled private claims. However, the Guaido Guidelines expressly state that claims that benefit from a valid first priority security interest in property of the Venezuelan state or its public sector entities may be given separate treatment in the renegotiation.[7]
4. *Financial Terms*: any arrangement with creditors (multilateral, bilateral and private) will be consistent with the economic recovery program supported by the IMF and other official sector sponsors.

The Guaido Guidelines, which are to be implemented by the interim government and the National Assembly of Venezuela, are subject to the following conditions:

(a) Nicolas Maduro must have stopped exercising administrative powers;

(b) the economic sanctions imposed by the US and other countries on Maduro's regime must have been lifted;

(c) an IMF Programme must has been put in place; *and*,

(d) a special law must has been passed by the National Assembly requesting the (interim or democratically elected) authorities to proceed with an orderly and consensual renegotiation of the legacy private claims.

In the text, the Guaido Guidelines already indicate that the interim administration is planning to 'play hardball' with questionable claims, particularly the bonds that were issued at discount by the central government to the Central Bank and then were off-loaded into the secondary market (i.e. the infamous 'hunger' bonds firstly acquired by Goldman Sachs[8] and Nomura[9]). In addition, more recently, PdVSA and PDV Holding filed a complaint against MUFG Union Bank (Trustee) and GLAS Americas (Collateral agent) seeking to declare the PdVSA2020 bond and its pledged collateral void and null arguing that the 2020 notes were not authorised by the National Assembly (in violation of articles 150 and 187 (9) of the Venezuelan Constitution).[10]

Of the four Guaido Guidelines, the more problematic is the one of equal treatment – since it seems to be an 'optical illusion'. Needless to say, from a political standpoint it is the right thing to say. However, its application would be limited due to the number of exceptions. First, considering that the Guaido Guidelines apply only to private debt, the equal treatment principle do not apply to bilateral and other multilateral debts – they are excluded because obviously they are not private in nature (and therefore excluded from the scope of the Guaido Guidelines). Secured claims are also expressly excluded in the Guaido Guidelines. Probably, the wording has been unfortunate and it should read 'comparable' or 'fair' rather than 'equal' treatment?

Then, the Guaido Guidelines state that no preferential treatment will be accorded in the debt renegotiation to claims that have been reduced to a court judgment and that claimants should refrain from pursuing legal remedies. However, if there is no firm court order, creditors can be subject to – as expected – a hefty haircut (e.g. through the use of collective action clauses). Therefore, pursuing a court decision and crystallising a claim's amount might not be a bad decision for creditors (although statutory applicable interests might be lower than contractual interests as we recently saw with the Argentine pari passu saga in New York). Favouring value creation by preventing a rush-to-the-court piece-meal approach should be desired in the benefit of the universe of creditors but experience has demonstrated that the interest of debtor and creditors (and even those among creditors) are not necessarily aligned. Moreover, the move against the PdVSA 2020 bonds will only accelerate litigation against Venezuela and its state-owned enterprises.

Notes

6 Available at https://twitter.com/AsambleaVE/status/1146961319037460480.
7 See the Guado Guidelines, page 2, under Guideline No. 3.
8 Kejal Vyas, Anatoly Kurmanaev and Julie Wernau, 'Goldman Sachs Under Fire for Venezuela Bond Deal', *Wall Street Journal*, 30 May 2017.
9 Anatoly Kurmanaev and Liz Hoffman, 'Nomura Bought Controversial Venezuelan Bonds at Steep Discount', *Wall Street Journal*, 31 May 2017.
10 See *Petroleos De Venezuela S.A. et al v MUFG Union Bank, N.A. et al.*, 1:2019cv10023.

3. Principles issued by the Creditor Committee

Shortly after the Guaido Guidelines were published, the Venezuela Creditors' Committee (the 'Committee'), issued its own 'Restructuring Principles and Framework' (the 'Committee Principles'). The Committee is comprised of long-term institutional holders of bonds issued by the central government, PdVSA and ELECAR, including individuals, pensioners, etc., who collectively manage more than USD 5.3 trillion of assets.

The Committee Principles state:

1. *Principle One*: A new Venezuelan government must be given time to address the urgent humanitarian needs of its citizens without the distraction and expense of ongoing litigation. However, any measures to stay litigation must not fundamentally impair the rights of creditors or undermine Venezuela's ability to attract private capital.
2. *Principle Two*: Consistent with the Principles for Stable Capital Flows and Fair Debt Restructuring outlined by the Institute of International Finance, a new Venezuelan government must provide timely and transparent information and financial reporting and engage with its creditors in active dialogue.
3. *Principle Three*: The Venezuelan government must establish a fair, reasonable and effective framework for restructuring and negotiate the terms of an equitable restructuring plan in good faith.

While reading the Committee Principles and the explanation to each one of them, it is evident that both camps (debtor v. creditor) are pushing the water to their own well (playing their own tug of war). The Guaido administration is trying to group all debts together, while the Committee is trying to treat the debts of the different debtors separate. For sake of simplicity, it is important to understand that if all claims are grouped together, the haircuts can be brutal. Some creditors, those who are in a better position, might end up being inflicted the same pain as the least 'covered' creditors on the back of the equal treatment principle (Guaido Guideline No. 3).

4. International standards

The overarching puzzling aspect with the Guidelines/Principles is why are the parties trying to reinvent the wheel? While no internationally agreed statutory regime has emerged to regulate sovereign debt restructuring, certain informal tools and mechanisms have been developed in this regard (see e.g., IMF, Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring, 2014).[11] These informal tools and mechanisms have been complemented by sets of informal principles developed by international organisations or associations grouping market players. The Principles for Stable Capital Flows and Fair Debt Restructuring, produced by the Institute of International Finance (the 'IIF Principles') have emerged as the standard of trade.

The IIF Principles incorporate voluntary, market-based, flexible guidelines for the behaviour of sovereign debtors and private creditors with the aim of promoting and maintaining stable capital flows, financial stability and sustainable growth.[12] The IIF Principles promote crisis prevention through the pursuit of strong policies, data and policy transparency, and open communication and dialogue with creditors and investors. The IIF Principles strive for effective crisis resolution through; inter alia, good-faith negotiations with representative groups of creditors and the non-discriminatory treatment of all creditors. The G20 Ministerial Meeting in Berlin has endorsed the IIF Principles in November 2004. The IIF Principles have then been further complemented in 2012 by the 'Addendum to the Principles for Stable Capital Flows and Fair Debt Restructuring' (the 'IIF Addendum').[13] The IIF Addendum outlines the recommendation to assess the recent experience with sovereign debt crisis prevention, management, and resolution in the Euro Area and elsewhere; drawing appropriate lessons; and making recommendations for the strengthening of the existing framework for sovereign debt crisis prevention and resolution. Therefore, it is puzzling why both parties are trying to rewrite long-established and generally accepted principles.

In fairness, the Creditor Committee Principles, embrace to great extent the IIF Principles. The only difference is that IIF's Principle No. 2 that deals with avoiding a restructuring does not apply and has been replaced by the provision of time to allow a new administration to resolve the more pressing matters. The Guaido Guidelines also embrace the IIF Principles (good faith, fair treatment and transparency). However, the Guaido Guidelines emphasise the need for a restructuring that has to be comprehensive and aligned with and economic recovery programme. This is common practice: debt sustainability and support by the IMF (and other donors) under an economic recovery programme (subject to conditionality) – no groundbreaking contribution.

Notes

11 See IMF, available at https://www.imf.org/external/np/pp/eng/2014/090214.pdf.

12 See IIF Principles, available at https://www.iif.com/Advocacy/Policy-Issues/Principles-for-Stable-Capital-Flows-and-Fair-Debt-Restructuring.

13 Ibid.

5. Concluding remarks

It would probably have been simpler for creditors to just embrace the IIF principles in their totality and stressed the different nature of the different debtors (central government, PdVSA and ELECAR). On the contrary, the Guaido administration, could had also simply endorsed the IIF Principles and had stated that to avoid a creditor v. creditor situation (Venezuela creditors v. PdVSA creditors v. ELECAR Creditors) it will treat all claims of the three debtors as a single government liability. This boils down to whether all debts should be grouped or not. As explained before, this is linked to the envisaged haircut to impose across all series of creditors. The rest, is just a matter of semantics. But let's not forget the urgency in stopping the humanitarian crisis, which without doubt is the more acute problem.

International Corporate Rescue

International Corporate Rescue addresses the most relevant issues in the topical area of insolvency and corporate rescue law and practice. The journal encompasses within its scope banking and financial services, company and insolvency law from an international perspective. It is broad enough to cover industry perspectives, yet specialized enough to provide in-depth analysis to practitioners facing these issues on a day-to-day basis. The coverage and analysis published in the journal is truly international and reaches the key jurisdictions where there is corporate rescue activity within core regions of North and South America, UK, Europe Austral Asia and Asia.

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