

## VENEZUELA

### The Supercuts Team

On July 3, the country's National Assembly published a document outlining the guidelines for the restructuring of the country's external debt. The publication of the Spanish document was followed on Sunday by an English translation posted on the Twitter account of José Ignacio Hernández – the Special Prosecutor General of Juan Guaidó's interim government. The four-page document, called "Guidelines for the Renegotiation of the Chávez/Maduro Era Legacy Public External Debt," outlines four basic principles which will guide the process: (i) comprehensiveness of renegotiation, (ii) reconciliation of claims, (iii) equal treatment of all creditors, and (iv) financial terms consistent with an IMF agreement.

Comprehensiveness implies that the process will try to cover all external financial claims against the Venezuelan government. Claims reconciliation implies an orderly process for ascertaining the recognition of claims. Equal treatment refers to the fact that all claims will be paid on the same terms. Consistency with IMF program captures the fact that the amount of debts to be recognized must sum to an aggregate debt burden that is deemed to be intertemporally sustainable by international financial institutions.

#### WHAT WE TALK ABOUT WHEN WE TALK ABOUT DEBT

In order to understand what the interim government means by comprehensiveness, we have to first

understand both what they mean by debt and what they mean by external debt. The document states that the renegotiation will cover "all the foreign currency-denominated claims against the Venezuelan public sector." While this definition does not explicitly distinguish claims from the private sector from those of other governments and multilateral bodies, the fact that the document does refer to "comprehensive private claims renegotiation" in one of the subheader titles and to the "orderly and consensual renegotiation of legacy private claims" in the text suggests that the government plans to treat bilateral debt with China and Russia – as well as the small multilateral debt with organisms such as CAF and the IADB – using other principles.

Nevertheless, what is noteworthy is the fact that the interim government assumes a definition of external debt based on currency of denomination rather than residence or governing law. The last of these is quite relevant, as it means that authorities are planning to treat creditors who have a New York law obligation similar to those that have obligations issued under local law (e.g., contractors of the state-owned oil company).

This definition of debt also introduces the complication of dealing with foreign-currency liabilities held by residents. For obvious reasons, there is no significant local-currency debt with foreign residents, but the amount of foreign-currency liabilities with Venezuelans is an issue of discussion. As of the end of 2018, we estimate that there were USD 20.7bn in foreign

The currency-based definition of external debt opens up the risk of local dollar claims for expropriations.

currency arrears generated as a result of commitments to sell foreign exchange at preferential prices to importers under the country's exchange controls system. These have their origin in cases in which importers claim to have brought goods into the country and sold them in domestic markets under the government's promise to transfer the dollars to the importer. Importers have claimed that these commitments gave rise to a foreign currency denominated debt against the government. Although they have not been able to successfully pursue this issue in local courts, the receptiveness of courts to this type of demands may be very different after a change in government.

There is also the issue of foreign currency bonds held by residents. According to the central bank, only USD 51.7bn of bonds and promissory notes were held by non-residents as of 4Q19, which implies that at least USD 14.8bn is held by resident units.<sup>15</sup>

These local holders include both public and private sector banks. The interim government's decision to say that it will treat all creditors equally implies a decision to abstain from using its regulatory power over private sector banks to force them to participate in the restructuring.

Yet perhaps the most important issue is that when a residency definition is not adopted, the door is left open to the presentation of a potentially large number of claims arising from demands by locals. If the sole determinant of whether you hold foreign debt is the currency of denomination, then a decision by local

courts that a debt should be recognized in dollars can turn a domestic liability into external debt. Venezuela's Supreme Court has already recognized the legal validity of wage claims in foreign currency<sup>16</sup> as well as the use of the country's cryptocurrency *petro* for compensation for "moral damages."<sup>17</sup> It is not inconceivable that future courts would rule that expropriated landholders must be compensated in foreign currency given the difficulties in establishing a meaningful nominal amount in local currency after the country's hyperinflation. Very few plaintiffs have successfully asked for compensation by courts for Hugo Chávez or Nicolás Maduro era expropriations, but we can expect this to change if a political transition takes place in which courts begin to act more independently.

The proposal intends to treat creditors equally regardless of whether they hold a New York law obligation or not.

This issue can be particularly relevant for the case of liabilities for expropriations and nationalizations. These are mentioned explicitly on page 1 of the document as an

example of the claims covered by the principle of comprehensiveness, regardless of whether they arise out of international arbitration.<sup>18</sup> The problem is that while we have some sense of what the government's liabilities are under claims taken to international arbitration, we have very little idea of the size of the potential claims that could be presented under local law. To take just one example, the government is estimated to have expropriated around 5 million hectares (12.4 million acres) since 2005.<sup>19</sup> Using the costs of Colombian land restitution purchases as a benchmark, this would imply potential liabilities of

<sup>15</sup> The Central Bank does not appear to be counting past-due interest in its latest tally of the country's external debt.

<sup>16</sup> [Condenan pago en divisas \(dólares\) a tasa DICOM en demanda laboral](#). [They condemn payment in foreign currency (dollars) at the DICOM rate in labor demand]. Acceso a la justicia. December 5, 2018.

<sup>17</sup> [Sentencia n° 1112](#). Supreme Court of Justice. November, 2018.

<sup>18</sup> The document does refer to arbitration claims under the explanation of the reconciliation principle, but only as an example of the issues arising in establishing the total amount of the claim to be recognized.

<sup>19</sup> ["Gobierno expropió más de 5 millones de hectáreas y están improductivas"](#) [Government expropriated more than 5 million hectares and they are unproductive]. El Nacional. April 16, 2018.

approximately USD 9.6bn. And this does not even begin to count expropriations of urban property, mines or manufacturing plants which are not subject to international arbitration arrangements.

Of course, there is nothing about the document presented by authorities that makes it legally binding at this time. But if a restructuring does go forward under these broad principles, we can surely expect that plaintiffs seeking compensation from the incoming government will attempt to get paid in foreign exchange and to be treated at least as well as foreign creditors. Whether they have the ability to do so will depend on local court decisions that may evolve in ways that are not easy to predict.

## EQUAL PAY FOR EQUAL DEBT

Perhaps the decision that has the greatest significance for bondholders at present is the decision to treat all private creditors equally. According to the guidelines “once the amount of a claim has been reconciled and accepted to be renegotiated, the claim shall be eligible to participate in the renegotiation on equal terms with all other reconciled private claims...no different treatment shall be accorded to eligible foreign-currency denominated claims as a result of their origin...the nature or domicile of the holder of the claim, and/or the identity of the public sector obligor.” The only exception is that of obligations that benefit from a collateral guarantee, such as the PDVSA 2020s.

This principle has significant potential implications. As of the end of 1H19, New York law foreign currency bonds and promissory notes summed USD 66.5bn (not counting an additional USD 12.6bn in past due interest),

or 37.4% of the USD 177.6bn in public sector external debt.<sup>20</sup> Up until 2017, the government prioritized payment on these obligations over its arrears to suppliers and even with respect to bilateral loans from China and Russia (which were renegotiated before 2017). This led bondholders to expect that they would continue to be treated with priority with respect to other creditors. What the new principles mean is that they can now expect to be paid on the same terms – and thus face the same haircut – as that of all other creditors.

Holders of New York law bonds may not react well to the idea that they will be afforded the same treatment as the holder of a commercial claim against PDVSA. The key question is whether they will be likely to try to use the courts to enforce their rights, and what steps the incoming government can take to protect the country against those actions.

To fix ideas, is it really reasonable to believe that ConocoPhillips – which was able to obtain decisions from courts in Curacao, Bonaire, Aruba and St. Eustatius seizing control of PDVSA storage facilities in May of 2018 forcing PDVSA to sign and begin to honor a USD 2.0bn payment agreement with them – will not use the same access to courts against a Guaidó administration that tries to force it to accept a potentially very large haircut on its claims? Conoco (or any other creditor with a claim that is enforceable in external courts) will likely argue that it obtained a legitimate right to the protection implicit in that enforceability – in Conoco’s case, by demanding that PDVSA sign an agreement subject to international

*Creditors may not be so keen to let go of their enforcement rights just yet.*

<sup>20</sup> Including resident holdings of foreign currency bonds and past due interest over bonds and promissory notes.

arbitration – and that having done so entitles it to priority over those that do not hold such rights.

It appears that the basic idea behind the equal treatment principle is to stave off litigation. Hernández told the *Financial Times* on July 3 that “we cannot allow special treatment because if we do, we are creating an incentive for litigation...The message is, ‘please don’t sue Venezuela because it will be a waste of money.’” However, the reality is that some creditors do have greater bargaining power because of their ability to

seek legal remedies in international courts and that they can be expected to use those rights to extract concessions from the government. In other words, the only way in which Venezuela can be expected to be successful in holding to the equal treatment principle is if creditors prove unsuccessful in enforcing their claims in international courts. Asking them nicely to put aside their claims may not be enough.

Table 4: Venezuela’s external debt

	2014		2015		2016		2017		2018		1H19	
	USDmn	% of GDP	USDmn	% of GDP	USDmn	% of GDP	USDmn	% of GDP	USDmn	% of GDP	USDmn	% of GDP
Bonds and promissory notes	50,666	28.0%	47,941	39%	46,897	41%	49,578	57%	51,717	72%	52,471	70%
Sovereign bonds	24,378	13.5%	23,211	19%	21,492	19%	20,898	24%	23,227	32%	22,821	31%
PDVSA bonds	25,866	14.3%	24,036	20%	23,637	21%	25,749	30%	25,570	35%	26,591	36%
PDVSA Promissory notes	-	0.0%	257	0%	1,340	1%	2,523	3%	2,523	3%	2,523	3%
Other	422	0.2%	437	0%	427	0%	408	0%	397	1%	536	1%
PDI on foreign holdings of bonds and promissory notes	-	0.0%	-	0%	-	0%	1,069	1%	8,871	12%	10,304	14%
Loans	40,386	22.4%	46,497	38%	45,456	40%	40,875	47%	34,642	48%	32,600	44%
Other external liabilities	37,776	20.9%	46,695	38%	48,041	42%	50,841	59%	56,713	78%	65,954	89%
of which: ICSID	11,611	6.4%	11,980	10%	12,338	11%	12,526	14%	11,752	16%	20,452	27%
<b>Public sector external debt</b>	<b>128,828</b>	<b>71.3%</b>	<b>141,133</b>	<b>116%</b>	<b>140,394</b>	<b>122%</b>	<b>142,363</b>	<b>165%</b>	<b>151,943</b>	<b>210%</b>	<b>161,329</b>	<b>217%</b>
Private sector	18,550	10.3%	21,823	18%	21,803	19%	21,199	24%	19,889	28%	19,218	26%
<b>Total external debt</b>	<b>147,378</b>	<b>81.6%</b>	<b>162,956</b>	<b>134%</b>	<b>162,197</b>	<b>141%</b>	<b>163,562</b>	<b>189%</b>	<b>171,832</b>	<b>238%</b>	<b>180,547</b>	<b>243%</b>
Resident holdings of bonds	20,536	11.4%	19,055	16%	23,129	20%	17,609	20%	14,768	20%	14,014	19%
PDI on resident holdings of bonds	-	0.0%	-	0%	-	0%	416	0%	1,578	2%	2,290	3%
<b>Public sector external debt, including resident holdings</b>	<b>149,364</b>	<b>82.7%</b>	<b>160,188</b>	<b>131%</b>	<b>163,523</b>	<b>142%</b>	<b>160,388</b>	<b>185%</b>	<b>168,289</b>	<b>233%</b>	<b>177,633</b>	<b>239%</b>
<b>Total external debt, including resident holdings</b>	<b>167,914</b>	<b>93.0%</b>	<b>182,011</b>	<b>149%</b>	<b>185,326</b>	<b>161%</b>	<b>181,587</b>	<b>210%</b>	<b>188,178</b>	<b>260%</b>	<b>196,852</b>	<b>264%</b>
GDP	180,648		121,936		115,010		86,530		72,308		74,432	
Total bonds and promissory notes outstanding	71,202	39.4%	66,996	55%	70,026	61%	67,187	78%	66,485	92%	66,485	89%

Sources: Torino Economics, BCV, MF, PDVSA, Bloomberg



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