

Thoughts on the Possible Restructuring of Venezuelan Debt

Hans Humes interviewed by LEC

Introduction

LEC Abogados is a top-tier financing, energy and transactional law firm based in Venezuela, with a very unique practical approach to the needs of our clients. Our partners in the areas of energy, corporate finance, structured finance, banking, securities, mergers and acquisitions, bankruptcy and reorganization, real estate, construction sector and financial dispute resolution, have strong academic backgrounds in their respective areas of expertise. LEC Abogados has many decades of combined experience working in some of the most complex deals in Venezuela as well as internationally with numerous successful deals in Latin America and now in Europe from our office in Madrid, Spain.

Considering the importance of a well balance and thoughtful program to renegotiate the sovereign/Pdvsa external debt, we have decided to open up a dialogue with important stakeholders of the financial, academic, legal and institutional sectors, to discuss key elements that might be incorporated in the possible scenarios that Venezuela would face in the process of restructuring and refinancing of its sovereign debt, as well as in the funding and execution of the reconstruction of the country.

Our interest is spreading the knowledge, expertise and our own views as legal experts in the possible solutions that would be considered for a proper and comprehensive negotiation program. Venezuela deserves a brighter future and we truly believe that collectively we will find the alternatives to create solutions that align the interest of the various parties involved in this very complex process.

The views and opinions expressed in these interviews are those of its authors and do not necessarily reflect the opinion and position of LEC Abogados or of any of its members.

Hans Humes



Hans Humes is Chairman, Chief Executive Officer and Chief Investment Officer of Greylock Capital Management, LLC., which he founded as a joint venture with Van Eck Global in May 1995.

Mr. Humes has over three decades of experience working in emerging markets. Humes was a Managing Partner of Van Eck Absolute Return Advisors, Inc. when he launched the fund which became the Greylock Global Opportunity Master Fund in 1997. From 1991 to 1994, he was a key member of the Lehman Brothers emerging markets debt trading team, co-developing the desk and managing over \$500 million in investments. Prior to that he traded a proprietary debt portfolio at Banco Santander and engineered several debt/debt and debt/equity swaps in Latin America. Humes began his career at Manufacturers Hanover, where he worked on the sovereign debt restructurings for the Philippines and Yugoslavia.

Mr. Humes has served on numerous sovereign debt restructuring committees, among them the Steering Committee of the Private Creditor- Investor Committee for Greece and the Global Committee of Argentine Bondholders (GCAB), where he was co-chair. Mr. Humes has been active in policy and regulatory initiatives affecting creditors globally. He is currently co-chair of the IIF Committee of Sovereign Risk Management, a trustee of the IIF's Principles Consultative Group (PCG) for the Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets, a member of the IIF Working Group on Reconciliation of Past Due Sovereign Debt and a member of the IIF Market Monitoring Group.

Mr. Humes is on the board of directors of the Georgie Badiel Foundation, which focuses on providing access to clean water and sanitation to the people of Burkina Faso and neighboring Sub-Saharan African countries, and the Wendy Hilliard Gymnastics Foundation, which provides gymnastics training for young people in Harlem. Mr. Humes is also on the board of trustees of the New York Theatre Workshop.

Mr. Humes received his BA from Williams College in 1987. He has lived and studied in Nigeria, Morocco, Canada, Netherlands, Chile, Mexico, and Belgium and is conversant in Spanish.

1.

What is a sovereign debt restructuring process?

Sovereign Debt Restructuring is a term used to describe a voluntary negotiation between creditors and borrowers focused on addressing the payment obligations of the borrower and potential modifications thereof.

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Generally the objective is to reduce or reorganize the borrower's payment flows to address an impingement on the capacity to fulfill obligations, while providing creditors with more predictable stream of cash flows.

In addition to modifying contractual payment terms, there is, depending on the profile of the debtor country, often substantial scope for the utilization of additional tools such as debt/equity swaps, as well as other equity-like or contingent payment instruments including GDP- or commodity-linked warrants and Value Recovery Instruments.

2.

What is the current situation of Venezuela in connection with its sovereign debt's obligations?

Venezuela and PDVSA are, with limited exceptions, in default on external bonds with a face value of nearly US\$60bn, as well as approximately US\$10bn in unpaid interest on these obligations. This is in addition to defaults existing with a number of other commercial, bilateral and multilateral lenders, which together with the bonds comprise Venezuela's approximately US\$160bn external debt stock. However, at the present time there can be no substantive dialogue between Venezuela/PDVSA and the majority of its creditors due to the sanctions imposed by the US.

3.

What sovereign restructuring precedent do you think more closely resembles Venezuela, and would best help Venezuela design its restructuring strategy? Is there anything to be learnt from past Veny restructurings? (i.e. Brady Bonds)

Debt to equity programs were omnipresent leading up to and during the Brady program and these types of solutions will be the single largest contributor to Venezuela's debt reduction as part of the forthcoming restructuring process.

Venezuela should avoid the antagonism Argentina has had vis a vis its creditors, as this will result in protracted litigation and is likely to produce an outcome that is far more expensive for the country than what can be achieved through a good faith negotiation.

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Similarly, any use of coercive mechanisms, as were applied in the case of Iraq, will be detrimental to a successful renegotiation.

4.

Any comments on the profile of the sovereign debt and debt holders? How would you deal with such a diverse profile? Any ideas on how to validate and adjudicate claims. How should a new government grade/ privileged Venny and PDVSA debt? publicly traded vs. commercial and judgment awards?

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A broad, representative committee will have to be formed, with representatives of each class of debt having a presence at the table.

A process similar to what was used in the BTA bank restructuring in Kazakhstan should also be instituted: i.e., a group should be formed to adjudicate dubious claims.

By having one committee representing ALL creditors, it is likely that creditors will assume a degree of accountability towards each other, and will be self-compelled to resolve inter creditor issues more quickly. While setting up a scenario in which creditors are incentivized to act against each other may appear to be a reasonable strategy for a debtor, the disruption it will cause will not be conducive to an expeditious outcome.

5.

Considering that Venezuelan holds the largest crude reserves of the world, would this need to be considered as a critical element in the sovereign restructuring process? (e.g., petroleum projects are capital intensive and would require access to international markets)



The oil and gas reserves are key – they are what make Venezuela a “liquidity issue” case, rather than that of a country experiencing a long-run “solvency issue.”

As mentioned above, large debt/equity swaps can be implemented to reduce Venezuela’s debt stock and facilitate foreign direct investment into the oil sector. If the existing Hydrocarbons Law is modernized to allow a greater percentage of foreign ownership in oil and gas JVs, it would be prudent to require foreign companies to tender debt in order to “purchase” this additional stake, for example.

In a restructuring scenario, the payment capacity of the country will only increase when oil production recovers, and a standstill can be negotiated with creditors to allow for a stable environment into which this investment can occur. However, it is clear that after a multiyear recovery, payment capacity will rebound to levels that can sustain the stock of debt that remains after any up-front haircut that may be implemented. Value recovery instruments can be designed for certain classes of creditors as well. These instruments could be tied to royalties paid by energy companies, or any other investment capital flows coming into the country

6.

What's your opinion on OFAC sanctions in connection with Venezuelan sovereign debt?

These sanctions were poorly designed for the problem it was claimed they were meant to address. The stated purpose of the secondary market trading sanctions was to block the ability of Maduro regime-related parties to sell bonds to fund their regime. They do not do that. The sanctions prevent US persons from buying bonds in the secondary market, and further specify that any sales must be made to non US persons only.

As a result, the option of selling to a non-US buyer remains if regime related-persons wish to sell. However, if US persons want to sell, or are forced to sell because of a reduction or elimination of Venezuela's index weighting in the EMBI (as was implemented by JP Morgan beginning in July 2019) or due to portfolio redemptions, the buyers will most likely be non-US persons who will almost certainly have interests that are not aligned with the US in how they intend to use the debt that is acquired.

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The longer the sanctions stay in place, the more debt will switch from US hands into these non-US buyers. This will dramatically change the expected outcome of any negotiated settlement.

7.

Do you think holdouts will constitute a serious obstacle for a successful restructuring? How would you deal with them?

If Venezuela and its advisors do not enter into negotiations with creditors in a hostile way, the holdout problem will be manageable and will be dealt with primarily by other creditors, ideally within the context of the representative creditor committee that has been described. The holdout issue reminds me of the antivaxxer crusade. While it's very alarmist, there's little content to the perceived problem, and there are ample tools to compel reluctant creditors to accept the terms of a negotiated settlement.

8.

What's your opinion on the possible liquidation/spin-off of assets of PDVSA into a new National Oil Company? How would you ensure the continuing operations of PDVSA/new National Oil Company, obtain access to markets and protect assets and operations?

There are a number of consensual ways in which this can be accomplished, including the negotiated standstill concept that would provide a stable environment for foreign direct investment into the energy sector. This would also provide an environment in which PDVSA can continue to perform any critical commercial and trading activities.

9.

Given the complex social, economical, political, legal situation of Venezuela, where would you invest your first dollar as head of a new government? And when to start a restructuring?

There will clearly be a need for any new government to focus on stabilizing the humanitarian situation within the country. While international donors and multilateral lenders are expected to provide a substantial portion of the required funding, the size of this financing package likely exceeds the immediate capacity of these entities. However, commercial creditors, including existing bondholders, have also expressed a willingness to lend new money in support of this effort.

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And any government should undertake an effort to select legal and financial advisors that will be capable of engaging with all potential lenders in order to maximize the amount of available resources for stabilizing the humanitarian situation within Venezuela.

LEC Abogados

LEC Abogados is a Law firm oriented to assist local and international clients in connection with their legal needs to implement and conduct businesses in Venezuela. Our aim is to provide international quality legal advice whilst understanding local realities.

Founded in August 2006, LEC Abogados results from the association of seven former partners of the most prestigious law firms in Venezuela, putting together a group of lawyers with a high recognition in their respective areas of expertise.

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CORPORATE FINANCE TEAM



Juan Carlos Andrade

📞 +58 414 2832667
☎ +58 212 7500080
✉ jcandrade@lec.com.ve



Rodolfo Belloso

📞 +58 414 2404863
☎ +58 212 7500080
✉ rbelloso@lec.com.ve



Leopoldo Cadenas

📞 +58 414 3333536
☎ +58 212 7500080
✉ lcadenas@lec.com.ve



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