



Thoughts on the Possible Restructuring of Venezuelan Debt

Mark Walker 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.

In view of 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 objective is to spread relevant knowledge and expertise and our own views as legal practitioners as to 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 of those being interviewed and do not necessarily reflect the opinion and position of LEC Abogados or of any of its members.

Mark Walker



Mark Walker has 40 years experiences advising more than 25 countries and their national oil companies and other state-owned enterprises on complex financial matters, including Mexico, Colombia, Argentina, Greece, Cyprus, Peru, South Korea, Indonesia, the Philippines, Hungary, Slovenia, the Ivory Coast and the Republic of Congo. Mark has also advised the European Stability Mechanism and other international organizations and is currently advising the Venezuela bondholders committee.

Mark was a partner at Cleary Gottlieb Steen and Hamilton LLP from 1975 to 2011 and the firm's Global Managing Partner from 2005 to 2011. He led and co-founded that firm's premier sovereign practice and developed much of the documentation that set the standard for sovereign debt restructurings during the 1980s and 1990s. Mark received a law degree from Yale Law School and a B.A. in English literature from Stanford University.

1.

What does it mean for a country to restructure its debt? Why do countries do so and what are the objectives of the debtor country and its creditors in the process?

Most countries finance a portion of government expenditures with debt issued on domestic or international markets or both^[1]. As debt matures, well-managed borrowers refinance it in the market. Debt levels may vary (mostly on the upside) with a country's needs and other resources, but with rare exceptions neither countries nor their lenders expect a borrower country to retire its debt in full or even in substantial part. When market conditions do not permit a country to refinance its maturing debts and the country does not have the resources on hand to repay amounts due, the country must either restructure its debts (meaning modify the payment terms—maturities, interest rates and even the amount of principal to be repaid), find a non-market participant willing to provide emergency finance^[2] or default. The first two of these alternatives are most frequently pursued in tandem when (as is often the case) the debtor country needs an infusion of new money that only an organization such as the IMF or the ESM has the capacity and willingness to provide.

The objective of a restructuring is not simply to avert default (which may as in the case of Venezuela, already have occurred), but to support an economic adjustment program that will lead to sustained economic growth and eventually to renewed market access.

From the debtor country's perspective, **the objective of a restructuring is to reduce debt service over time**

to sustainable levels and give the country space to adjust without inflicting undue pain on its people. This may entail merely an extension of maturities (a "reprofiling" in the jargon) or a partial forgiveness of amounts owing by means of a reduction in interest rates or a partial forgiveness of principal (a "haircut").

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For creditors, the objective is to recover as much of the amounts owing to it as possible, consistent with the debtor's return to debt sustainability.”

At one level, then, the objectives of both debtor and creditor are consistent. But there is no scientific method of determining what level of debt and what repayment profile is necessary to make debt sustainable. How an adjustment program should be constructed and the timeline for implementation are inevitably hotly debated—even among disinterested economists. A country will always want to take a conservative approach to protect against shocks, exogenous events and mistakes, and creditors will resist foregoing value simply to give excess breathing room to their debtor, which after all, they will argue, must bear responsibility for its own policies. That said, with the exception of holdout creditors unwilling to negotiate or join a consensual deal, in most cases debtor countries and the great majority of their creditors act constructively and in good faith to reach a consensual agreement.

¹ Countries without debt are, for the most part, either blessed with substantial oil wealth and the discipline to live within their means (and that has changed as oil prices have receded from historic highs and oil producing countries have become committed to substantially increased government expenditures) or lacking in creditworthiness (and this too has changed as interest rates reached historic lows and credit standards declined in search of yield, welcoming frontier market borrowers for the first time).

² Typically, financial assistance is provided by multi-lateral institutions such as the International Monetary fund (IMF) or the European Stability Mechanism (ESM), or bilaterally, as was the case when Abu Dhabi came to the rescue of Dubai or (in a more coordinated fashion) when creditor countries restructure bilateral debts under the auspices of the Paris Club.

2.

What are the major issues that will need to be addressed as Venezuela seeks to restructure its debt (other than the financial terms of the restructuring itself), and what tools are available to manage them?

Among the critical issues that will need to be addressed are the following:

- Identifying and valuing legitimate claims.
- Creating an effective process to deal with diverse creditors on a consistent and coherent basis.
- Developing together with the IMF a credible economic program based on a realistic debt sustainability analysis adequate support from the official sector and equitable burden sharing among all stakeholders.
- Protecting assets of PDVSA for the benefit of Venezuela and creditors as a whole, and
- Dealing with holdouts

VETTING CLAIMS:



Venezuela will need to construct a credible process to determine the legitimacy and value of claims to be restructured. This will not be an easy task and it is important that decisions be made by an independent body and subject to review and challenge.”

Questions of legitimacy and value will include but not be limited to distinguishing between fraudulent and bona fide claims and determining whether amounts claimed have been improperly inflated. The legitimacy of claims may also include a determination of whether a claim represents an obligation that has been lawfully incurred or for which the Republic or PDVSA is liable as a matter of law.

The interim government has suggested in its published guidelines (the interim government guidelines) that the recognized value of claims may reflect treatment of original issue discount; this may turn out to be a contentious subject depending on the approach taken. Claims that are being contested in litigation or arbitration may have to await a final decision unless the parties can agree on an amount to be recognized for purposes of the restructuring.

The interim government guidelines contemplate that all unsecured claims of private parties (bonds, loans, commercial claims, judgments and awards) will be treated alike, but that bilateral claims of governments and the public sector will merit different treatment. Whether all government and public sector claims should themselves be treated alike, whether their nature or value may be questioned, how government creditors will equitably share the burden of the restructuring are all questions that, given the large quantum of these claims, are likely to pose difficult issues that in the end can only be resolved by consensus.

Diversity of creditors, protecting assets of PDVSA and dealing with holdouts. These are issues that are common to many sovereign restructurings, though they could potentially be particularly troublesome in the context of Venezuela, given the magnitude of claims held by various creditor groups, the lack of effective contractual provisions to deter holdouts and the importance to Venezuela of revenues from sales of oil.

As is well known, sovereign restructurings, as opposed to corporate workouts and bankruptcies, lack both a judicially enforceable means to compel dissenting minority creditors to abide by the terms of a restructuring agreed by the debtor and a requisite majority of creditors, as well as a mechanism to protect the debtor's assets pending agreement on a restructuring plan. The introduction of aggregated collective action clauses in bond documentation is the market's best effort thus far to deal with the first of these. In the case of Venezuela, however, none of PDVSA's bonds contain collective action clauses and the bonds issued by the Republic contain old style clauses that operate on a bond issue by bond issue basis and require a high threshold to become effective. Moreover, collective action clauses are of no effect in the case of other creditor groups—commercial creditors, arbitration and judgment creditors and so forth.

Fortuitously, as Richard Cooper, a senior partner at Cleary Gottlieb Steen & Hamilton and I have written ^[3]^[4], there is an elegant solution at hand in the case of PDVSA. The first step would be for Venezuela to enact a new law that would enable PDVSA to restructure its liabilities through a process that is consistent with Chapter 15 of the US Bankruptcy code. The new law would be administered by a special court to be established with newly appointed independent judges. PDVSA and its creditors (all of them, not just bondholders, but separated into different classes if and to the extent appropriate) would then seek to negotiate a consensual restructuring. If approved by the requisite majority—say 66-2/3 % of creditors and agreed by PDVSA, the terms of the restructuring would bind all creditors, whose original claims would be discharged once the plan of restructuring became effective. And in the interim, PDVSA's assets would be protected by a judicially mandated stay. This process would in turn be supported by a Chapter 15 proceeding (and similar proceedings in other jurisdictions), as a result of which PDVSA's assets would be protected in the US and these other jurisdictions as well and dissenting creditors would be bound by the terms of the restructuring. Although this process would not directly protect the Republic it would facilitate a restructuring of the Republic's debts as well.

³ Walker, Mark A. and Richard J. Cooper (expressing the authors' personal views only). "Venezuela's Restructuring: A Realistic Framework." (2017): 1-32. doi:10.2139/ssrn.3039678.

⁴ Cooper, Richard J. and Mark A. Walker (expressing the authors' personal views only). "Venezuela's Restructuring: A Path Forward." (2019): 1-17. doi:10.2139/ssrn.3361887.

3.

Are the U.S. sanctions effective?

There is no question that the sanctions have led to increased financial pressure on the Venezuelan regime. They have also, inevitably, added to the hardship of the Venezuelan people. What they have not done is to accomplish their presumed objective of forcing the Maduro government to step down.

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The longer Maduro remains in power and the longer the sanctions add to the misery of ordinary Venezuelans, the more important it is to find another way to bring about the desired change in government.”

The sanctions now prohibit US persons from acquiring Venezuela or PDVSA bonds—even from another US person. Given the overwhelming presence of US investors in this market, the consequence has been a severe and totally artificial decline in bond prices to levels well below what most knowledgeable observers believe will be their value in a consensual restructuring. As a consequence, US investors (including large pension funds) are suffering unnecessary losses and non-US speculators, who may have no interest in a consensual restructuring are being offered bonds at prices that will almost certainly assure them of significant windfall profits. Of critical importance is the fact that this trading ban on US persons is of no consequence whatsoever in terms of creating or adding to pressure on the Venezuelan regime or bringing about a change in that regime.

4.

What might a restructuring and financial recovery plan look like?

Putting aside the financial terms, the elements of a restructuring are likely to include the following:

- Debt securities.
- A value recovery instrument. (Variable payment instrument)
- Potentially, new money financing from the private sector.
- A debt for equity program.
- Of course, **Venezuela will require a very large financing program to rebuild reserves, stabilize the currency, finance imports and generally reform its economy**, almost all of which will be funded by the IMF, and other International Financial Institutions.
- And to rebuild its oil industry and stabilize and increase production levels, Venezuela will require massive private investment in the sector.

The debt securities will be designed to constitute sustainable debt, which will likely mean relatively low payments for the short to medium term and in the case of debt owed to private parties, an aggregate principal amount representing a haircut from the amount outstanding today. It remains to be seen how bilateral creditors will contribute to the restructuring but in all likelihood a significant maturity extension and perhaps reduced interest rate will be key features.

The value recovery instrument should be designed to allow private creditors to recover amounts foregone in the restructuring, based on Venezuela's economic recovery as measured by reference to an objective variable that can serve as a proxy for recovery, likely linked to oil prices and volumes.

New money financing may be a voluntary facility, participation in which might afford added benefits in terms of access to the debt for equity program or the terms of the restructured debt.

Finally, the debt for equity program would allow creditors to participate in Venezuela's recovery, while at the same time requiring participants to fund investment needed to develop and exploit the assets acquitted under the program.

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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