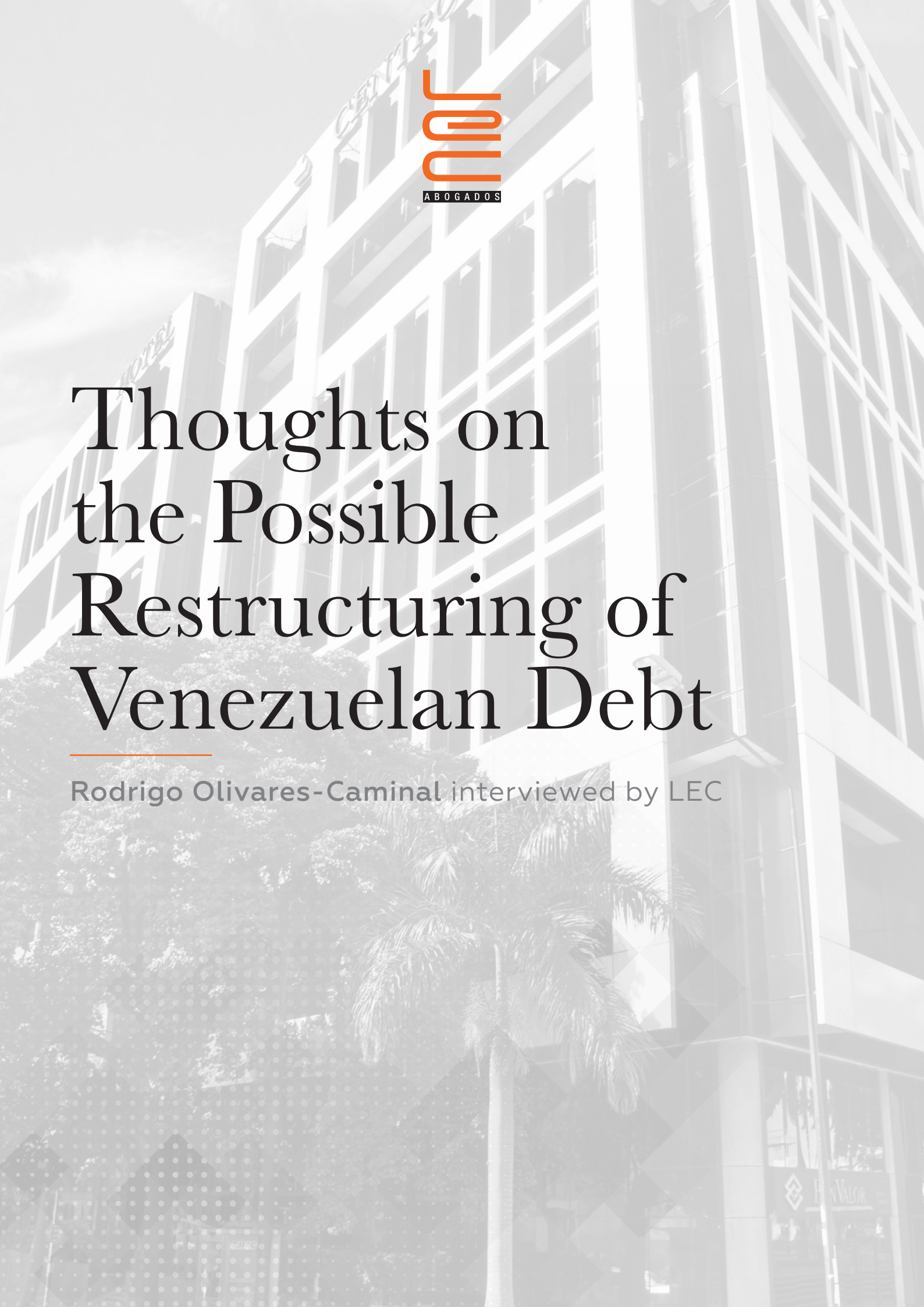

ABOGADOS

Thoughts on the Possible Restructuring of Venezuelan Debt

Rodrigo Olivares-Caminal 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.

Rodrigo Olivares-Caminal

Rodrigo Olivares-Caminal is a Professor in Banking and Finance Law at the Centre for Commercial Law Studies (CCLS) at Queen Mary University of London. Prior to joining CCLS he was a Senior Lecturer in Financial Law and the Academic Director at the Centre for Financial and Management Studies (SOAS), University of London and the School of Law, University of Warwick. He taught in undergraduate and postgraduate courses in various Schools of Law and Business Schools in the United Kingdom, Spain, Italy, Greece, France, China and Argentina as well as in professional training courses in Africa, Asia and Europe.

He has acted as a Sovereign Debt Expert for the United Nations Conference on Trade and Development (UNCTAD), Senior Insolvency Expert for the World Bank/IFC and as a consultant to several multilateral institutions in Washington DC and Europe, Central Banks and Sovereign States as well as in several international transactions with Law Firms. He specialises in international finance and insolvency law. He is the author/editor of seven books and has extensively published in peer-reviewed journals. He sits in the editorial/advisory board of several law journals in the UK and US and is a member of national and international institutions and associations specialised in comparative commercial and insolvency law.

1.
What is a sovereign debt restructuring process?

The main purpose of sovereign debt restructuring is to try to remedy an ongoing situation where basically the sovereign tries to reduce the servicing costs for outstanding debt obligations. Usually the situation is triggered as result of an imbalance of payments, a natural disaster or any situation where the government needs to reduce the cost for servicing its sovereign debt obligations.

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> The main aim is to regain debt sustainability levels and there are only three techniques to deal with the problem: extending maturities, reducing interest rates or reducing the face value of the claim (or a combination of these).

To achieve this, the sovereign will have different tools such as Collective Auction Clauses (CACs) or the use of voluntary exchange offers where you extend an offer to your creditors to exchange their previous debt instruments in default for a new instrument that will be performing and will usually have some contractual sweeteners to make it more appealable for the creditors. You can enhance creditor participation by combining a voluntary exchange offer with the use of exit consents.

Collective Auction Clauses are clauses that can be included in the terms of the bond at the time of issuance, and if that is the case, they allow a majority of holders to agree to change the terms of the bond including the so-called ‘reserved matters’. This qualified or reserved matters are usually those linked to the financial terms of the bonds (i.e. principal, interest, currency, maturity etc.). Just as a general comment on Venezuela, the government bonds include CACs on most of the instruments although there are some instruments that do not have CACs.

However, the Government bonds provide for different qualified majorities. Another important aspect is that the Venezuelan government bonds do not include the possibility of restructuring more than one debt instrument in one go (also known as aggregation), so you will have to do it bond by bond.

Aggregation is very important, once you reach the required majority you can restructure all (or more than one) bonds in a single exercise. With no aggregation you will need to craft majorities in each bond that you want to restructure. However, when restructuring each bond separately, not reaching the majority in one issue will result in that bond not being restructured through the use of CACs. This might create two categories of bonds, those being restructured and accepting a hefty haircut and others that are not. This happened in Greece were some bonds receive a 53.5% haircut and others were honoured at full face value.

Exit consent is a technique that was developed in corporate bond restructuring. Usually when you do a restructuring the issuer ask holders to exchange the old bonds into new bonds, what usually happens in this process is that the sovereign asks creditors to give their consent that, once they have accepted to an exchange offer, they also give a proxy to represent them in a bondholders meeting (if you decide to call one, and once you reach the required majority to amend matters that might be relevant for creditors but are not considered reserved matters (for example, you may change Governing Law and Jurisdiction, delist the bonds, remove the negative pledge clause, etc).

In essence what you are doing is, removing some features of the bond to make it less attractive, so those creditors that may consider holding out and not participate in the exchange offer are forced to join all those that have accepted because otherwise they will end up with an unattractive bond which would be very difficult to enforce as it lacks many of its key original features.

A voluntary exchange offer basically is asking creditors to voluntarily return an old bond (the one that is in default) and get in exchange a new bond that will be performing.

When you do an exchange offer, usually you will include some "sweeteners" (or contractual enhancements) to make the offer more appealable. The rationale for doing this is that you are exchanging an instrument with better terms (i.e. face value, interest, payment terms) but that is nonperforming, for other instrument with worse terms but with the expectation of performance.

Therefore, in order to make the exchange appealable some reassurances, protections or upside potential must be given (not necessarily in financial terms but in legal terms). A couple of examples that were used by Ecuador in the past where (i) the commitment to buy regularly a given percentage of the outstanding bond between the day it was issued and maturity, what you are basically doing is reducing the total outstanding amount of debt to make the total amount of debt more manageable; and, (ii) another example is the principal reinstatement clause where the issuer is forced to reduce the total face value of its outstanding debt at the moment of the exchange offer and if another default occurs, the principal amount reduced will be reinstated. In the case of Argentina, for example, the issuer agreed not to grant better terms to holdout creditors and if better terms were offered, said new terms would be extended to the holders of the instrument who decided to accept the voluntary exchange offer. The purpose of this is to ensure that holdout creditors will not be able to get better terms for holding out.

2.
What is the current situation of Venezuela in connection with its sovereign debt's obligations?

This question can be answered with a single word:

> **It's a mess!** It is a sovereign debt crisis, that has developed into a full-fledged humanitarian crisis and this is on the back of a country sitting on the biggest oil reserve in the world.

The situation in Venezuela is very complex, because they have too many outstanding liabilities of different types. Venezuela mainly has two layers of debt, one is from the central government and the other one is from the state-owned oil company PDVSA; in the case of the bonds, you have some instruments that have CACs; others that not have CACs; some bonds have CACs with 75% majority requirement and others with 85%; you have some promissory notes and several other bilateral debt obligations. It is a complex mix of different financial instruments with different legal terms. If you have different contracts with different rights and obligations, what you need to bear in mind is, that on the one hand it will be difficult to deal with, and on the other hand, you have a handful of different creditors with probably different interests: institutional, domestic, geopolitical investors and trading partners in the mix which also add another layer of complexity and all of these covered by different legal regimes.

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)

Each case is different although I would say that each time that we are faced with a new sovereign crisis a new lesson is learned, a new tool is added to the sovereign debt toolkit.

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> Past restructurings may not resemble the Venezuelan case, but they have something to contribute because, as you might be aware, there is no formal restructuring regime to deal with sovereign debt, which make the effort more challenging.

When you are dealing with sovereign debt, you're not just dealing with legal issues but also dealing with economic, financial, political and social issues. It is a multiheaded monster that has different needs and priorities. So, if you ask me, from each prior restructuring there is something that you borrow or something that you have learned that is not convenient to do.

I will reflect on the relative recent cases of Argentina, Iraq, Greece and Belize as they are relevant for Venezuela's reality. In the case of Iraq for example, you have the experience of the protection of assets. In Iraq, the main source of income was oil, so a resolution of the UN Security Council was passed that in essence said that oil reserves were not to be attached. Thus, protecting the main source of income for Iraq, as is for Venezuela. Then we'll be moving to how to do the restructuring and that's where I will borrow from Greece, Argentina and Belize. The latter, Belize, put at the center of everything the interaction with creditors, with full transparency, providing clear information on financial data to creditors and posting possible restructuring scenarios on the website of the Ministry of Finance. The effort was to engage creditors through a creditors committee in a friendly way to try to mutually reach an understanding.

In the case of Greece, for example, they retrofitted the CACs in those debt instruments that did not have CACs. In the case of Venezuela, it would be slightly more difficult because the bonds that do not have CACs are governed by New York law. In other words, the sovereign will not be able to muddle with the original contractual terms. However, there are other options being considered to achieve a similar outcome, e.g. how to achieve some kind of universal restructuring of all outstanding liabilities. I'm not a great fan of mandatory restructuring techniques. I prefer a voluntary understanding and creditors clearly know and understand the situation of Venezuela.

From Argentina we can learn two important lessons: first, that you should not underestimate creditors, unless you want to risk years of litigation; and secondly, that you can manage to achieve an upfront face value reduction in exchange for a potential upside upon an economic recovery with the use of GDP-linked warrants or value recovery rights.

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 the government grade/privileged Veny and PDVSA debt? publicly traded vs. commercial and judgment awards?

I prefer not talking about privileged debts or debts that have priority over others. In the context of sovereign debts there is not such thing as, and let me here be very technical, as privileged debts, although that does not necessarily mean that in practice sovereign sometimes prioritize some debts over others, but on paper most sovereign debt obligations are unsecured, unsubordinated, unguaranteed debt obligations of a government. The only debt that has some kind of priority is that of the IMF. The IMF enjoys of a non-written priority, which is some kind of ad-hoc practice over the years, that has granted the IMF a preferred status.

Next, with respect to the validation and/or authentication of claims, I don't think that this is needed as the debts are properly documented and the value is determined in the debt instruments. However, a two-fold analysis opens, the debtor (i.e. the sovereign government/PDVSA), would like to pay as little as possible, preventing any disruption, while at the same time being able to access credit. The counterpart, i.e. the creditors, would like to collect as much as possible and they would use any possible technique. What you will have to bear in mind is that there will be different types of creditors. You will have bilateral creditors that due to their geopolitical interest can wait and see how this can be resolved. Then, there will also be institutional investors that after three months would have to treat this debt as non-performing and are more eager in reaching a rapid resolution. Another sub-category include the distressed specialized investors who are after an economic return. Finally, the retail investors who might have invested their life-savings into a Venezuelan bond. This clearly indicates that creditors have different agendas and objectives as their interests are not necessarily aligned.

So if you ask me how this will be resolved?

> "Well, I think that the Government will be brutal aiming for a very step discount because, based on what is reported by the international press, Venezuela will require huge amounts of funds to solve its humanitarian crisis and rebuilding effort. And I think that the government will probably be emboldened by multilateral support in that direction.

But on the other side, I think that there is room for an understanding and to minimize litigation. I think it's more about the optics, how you present things to come up with creative means to give something to investors that it will surely reassure that if there is a recovery they will also be able to receive valuable benefits.

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)

I recently wrote a short piece for the Financial Times, about the situation in Mozambique. Basically what I was saying is that the government needed to settle with its creditors as soon as possible, because once settled, the country would be able to regain access to the financial markets, which is what they desperately needed to develop liquefied natural gas projects. In a sense, it is the same situation of Venezuela and its oil industry.

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> So, the sooner that Venezuela can overcome its debt crisis, the sooner the country will regain access to international financial markets, desperately needed at the moment to increase the production of oil.

The example of Mozambique is an excellent example to illustrate the situation of Venezuela.

6.

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

Yes, I think holdouts can be an obstacle. It is important to bear in mind that holdouts aim is to try to recover on a validly binding legal claim that they have against the debtor, and with little exceptions, they have lent the money and the debtor has benefitted from that money.

We need to, not really see them as an obstacle, but probably like individuals that are trying to recover what is truly owed to them. And as to how to deal with them, I think this is a theme that has already been addressed, with the use of CACs, exit consents, voluntary exchange offers, etc.

7.

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, access to markets and the protection of assets and operations?

What we need to bear in mind is that, at this state this is a bit of "blue sky thinking", there's nothing concrete yet. However, I would say that there are a couple of precedents which can illustrate the situation. One is "Agrokor", a state-owned Croatian company that was declared systemically important. It was not a bank but an agro-chemistry company, and what happened there is that they declared it systemically important, that they enacted a special law to deal with the insolvency of the company. It was an ad-hoc insolvency regime for that company that basically prevented it from going bankrupt.

The other is Puerto Rico and PROMESA, in such case a sort of an ad-hoc regime was created to deal with the liabilities of Puerto Rico. What we need to bear in mind is that the central government aim is to maintain fundamental government functions; but at the same time protect the rights of creditors in order to prevent the deterioration of asset value resulting from creditors rushing into the courthouse. Maintaining an open and effective communication with creditors is part of the solution. The key secret is that if you do not have open dialogue you are not going to reach a consensual agreement. Lack of a consensual agreement will result in years of litigation, as was the case of Argentina.

Another matter that we need to carefully consider is whether you want to mingle everything into a single box or not. You have the case of Cristallex, where the central issue is whether PDVSA is an instrumentality of the central government or not, and whether everything is already commingled or not. The question is what are the advantages and disadvantages of treating the PDVSA debts and sovereign debts as one or as separate. Under the current circumstances, in theory we are still facing two separate and distinct legal entities.

Before we consider to restructure one single entity or both separately we need to assess how they are going to be considered from a legal point of view. So the question here is whether from a legal point of view, the sovereign and PDVSA's debt obligations are subject to the same laws or not. If they are already commingled then you should do a single restructuring. If you have to deal with two different sets of laws, they are two separate entities. If PDVSA is not an instrumentality, with completely separate functions, separate assets and liabilities, then you can stand a chance of doing two different restructurings.

8.

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?

About the second part of the question, i.e. the "when", I think is now or not even now but yesterday. And with respect to the first part I would be a pragmatist and recommend the central government to invest in "a restructuring lawyer". If the central government manages to achieve a quick restructuring it will get the cash flow and investments required to solve the social crisis faster.

> "The same advice will go for creditors: **hire a restructuring lawyer, now!**

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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