Hughes Hubbard & Reed

Early Reactions to U.S. Venezuelan Oil Sanctions

Client Advisories

Hughes Hubbard & Reed LLP • A New York Limited Liability Partnership
One Battery Park Plaza • New York, New York 10004-1482 • +1 (212) 837-6000

February 13, 2019 – On January 28, 2019, the U.S. Department of the Treasury, Office of Foreign Assets Control (OFAC) designated Venezuela's state-run oil company, Petróleos de Venezuela, S.A. (PdVSA) as a Specially Designated National (SDN) pursuant to Executive Order 13850, which we previously summarized. The action marks a dramatic escalation in U.S. sanctions against Venezuela's oil industry.

OFAC also amended two frequently asked questions (FAQs) and issued 11 new FAQs in connection with the designation. The sanctions follow the United States government's endorsement of Juan Guaidó as Venezuela's legitimate president, while President Nicolás Maduro continues his efforts to cling to power. Treasury officials have warned that the sanctions will remain in place until Maduro transfers power to Guaidó or another democratically-elected government, with Secretary Mnuchin stating, "The path to sanctions relief for PdVSA is through the expeditious transfer of control to the Interim President or a subsequent, democratically elected government."

The sanctions are already having an immediate impact in world oil markets, with countries both aligned with and adverse to the Maduro administration considering their options. The long-term effects of the sanctions on Venezuela and consumers of Venezuelan oil will become clear if regime change does not occur in the near future.

Overview of PdVSA Designation and Related Actions

The sanctions are comprehensive; they block all property and interests in property of PdVSA that are subject to U.S. jurisdiction, which effectively prohibits PdVSA from engaging in transactions involving U.S. persons or conducted in U.S. dollars unless otherwise authorized by OFAC. U.S. officials estimate the sanctions will block $7 billion in assets and cause $11 billion in export losses for Venezuela's government over the next year. Petroleum exports constitute Venezuela's primary source of revenue and foreign currency.

In conjunction with the sanctions, OFAC issued several general licenses (GLs) authorizing certain short-term transactions and activities related to PdVSA and its subsidiaries. These GLs, in pertinent part, exempt CITGO Holdings from the sanctions until July 27, 2019 (GL 7); authorize certain U.S. entities – Chevron Corp., Halliburton Co., Schlumberger Ltd., Baker Hughes, and Weatherford International Ltd.— to continue their operations in Venezuela involving PdVSA or its subsidiaries through July 27, 2019 (GL 8); authorize maintenance and wind-down activities for U.S. persons working for non-U.S. entities abroad through March 29, 2019 (GL 11); provide a 90-day period to wind down activities related to the importation of PdVSA petroleum products into the U.S. (GL 12); and exempt from the sanctions transactions and activities involving Nynas AB, a PdVSA subsidiary (GL 13).

Since the initial announcement on January 28, 2019, OFAC has also amended GL 3 and GL 9, with the latest amendments (GL 3C and GL 9B) issued on February 11, 2019. These GLs allow persons subject to U.S. jurisdiction to continue to deal in certain enumerated bonds issued by the Government of Venezuela and PdVSA and to divest themselves of interests in PdVSA and its controlled subsidiaries within a given period of time. The amended GLs, along with newly-issued FAQs, aim to clarify whether and how U.S. citizens can sell Venezuelan debt to non-U.S. persons. The new guidance extends the wind-down time for contracts and agreements to March 11, 2019, and explains that U.S. companies and individuals may act as custodians for non-U.S. persons after the non-U.S. persons have received Venezuelan bonds from a U.S. person in a divestment transaction. The amendments were made in response to an initial halt in trading of Venezuelan debt and bonds after the sanctions were announced on January 28.

Early Reaction to the Sanctions

Since the U.S. government announced the PdVSA sanctions, crude oil exports from Venezuela have plummeted, and the Maduro administration has sought legal relief and work-arounds from the international community. Mr. Maduro has appealed to OPEC to condemn the U.S. sanctions, arguing that the sanctions will have a global impact on oil prices. However, OPEC has thus far declined to comment, continuing its avoidance of political disputes involving member states. PdVSA is also seeking a barter agreement with India to receive medicine and other products in exchange for crude oil exports.

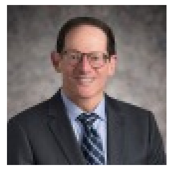
It remains unclear whether the Maduro regime can blunt the effect of the PdVSA sanctions by seeking partnerships with friendly countries, which largely fall on familiar fault lines. Russia and China, for example, continue to provide political and economic support for the Maduro administration despite U.S. sanctions. However, Russian oil producer Rosneft, which is itself subject to U.S. sectoral sanctions and is one of the largest international investors in Venezuela, has felt the fallout from the sanctions in the operation five of its joint ventures with PdVSA. Rosneft has invested over $1.4 billion in Venezuelan projects, but the sanctions will impact the joint ventures' cash flows by reducing its ability to monetize its stake in PdVSA's U.S. subsidiary, CITGO. Together, Russia and China have lent Venezuela nearly $70 billion in oil-backed loans, and Venezuela's ability to service those loans is imperiled by U.S. sanctions on the country's oil industry. This dynamic could have a spill-over effect in the U.S.'s increasingly antagonistic rhetoric towards the two countries.

Meanwhile, the U.S. and other Western economies that rely on the U.S. dollar for oil trade are preparing to withdraw from their engagements with PdVSA if regime change is not effectuated in the near term. In particular, U.S. oil refiners, other than those identified in GL 8, must now wind down their business with PdVSA no later than April 28, 2019, and in accordance with GL 12, make all payments owed to PdVSA into an interest-bearing blocked account based in the United States, an arrangement which PdVSA has refused to accept in lieu of up-front payment. Non-U.S. companies reliant on access to the U.S. economy are also preparing to wind down business with PdVSA in order to mitigate their own potential sanctions liability. For example, Spanish energy company Repsol, which has the largest international stake in Venezuela's crude oil, has indicated it is unsure whether it will continue importing oil from Venezuela. However, it remains to be seen if the curtailing of demand for PdVSA's petroleum will have a price effect on the world-wide market. If so, U.S. regulators could face pressure from allies and strategic partners to grant additional sanctions waivers to purchase Iranian petroleum, known as Significant Reduction Exemption (SRE) waivers, in order to keep global prices from rising dramatically.

Much will depend on developments in Venezuela over the coming few months. If Mr. Maduro cedes power, the PdVSA sanctions could be lifted quickly. On the other hand, a continuing political standoff will almost certainly lead to further economic turmoil.

Related People

Ryan Fayhee



Alan G. Kashdan

Tyler Grove

Sydney Stringer

Related Areas of Focus

International Trade

Sanctions, Export Controls & Anti-Money Laundering