

# Pratt's Journal of Bankruptcy Law

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# \$1.2B Order Entered Against Petróleos de Venezuela: Q&As for PDVSA and Citgo Commodity Commercial and Trading Counterparties

*By Robert J. Gruendel, Mark A. Waite, and Deanna R. Reitman\**

*In Crystallex International Corporation v. Bolivarian Republic of Venezuela, the U.S. District Court for the District of Delaware has issued an order and supporting opinion allowing a judgment creditor holding a \$1.2 billion judgment against the Bolivarian Republic of Venezuela to attach common stock owned by Petróleos de Venezuela, S.A., the national oil company of Venezuela. The authors of this article answer key questions the industry is asking.*

The U.S. District Court for the District of Delaware has issued an order and supporting lengthy opinion allowing a judgment creditor, Crystallex International Corp., holding a \$1.2 billion judgment against the Bolivarian Republic of Venezuela to attach common stock owned by Petróleos de Venezuela, S.A. (“PDVSA”), the national oil company of Venezuela. The stock attached by the order is the common stock of PDV Holdings, Inc., which in turn is the parent company of Citgo. The case is *Crystallex International Corporation v. Bolivarian Republic of Venezuela*.<sup>1</sup>

## **BACKGROUND**

The order arises from a 2016 arbitration award in favor of the creditor which claimed that Venezuela wrongfully expropriated gold mines in or about 2011. PDVSA was not a party to that arbitration and was not accused of any involvement in the underlying matters giving rise to it. The arbitration award against Venezuela was confirmed by the U.S. District Court for the District of Columbia, and Venezuela filed an appeal of that judgment, which remains

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<sup>1</sup> C.A. No. 17-mc-151-LPS.

pending. Venezuela was not successful in its efforts to stop post-judgment collection efforts while it appeals that judgment. The order is part of Crystallex's post-judgment collection efforts.

PDVSA filed a notice of appeal on August 10, 2018 and, later that month, filed a petition for a writ of mandamus to the U.S. Court of Appeals for the Third Circuit.

After PDVSA filed its notice of appeal, CITGO Holding, Inc., and CITGO Petroleum Corporation jointly urged the district court to stay execution of the writ of attachment to allow them to propose how to best accomplish the execution of the attached shares. Soon thereafter, the court issued an order temporarily staying execution of the writ of attachment and invited parties and non-parties alike to submit motions within seven days of the service of the writ of attachment on how to best effectuate the execution of the writ of attachment. Moreover, the court specifically invited PDVSA to file a motion under Rule 62(d) of the Federal Rules of Civil Procedure and post a supersedeas bond to stay execution of the writ of attachment pending the outcome of PDVSA's appeal.

On October 26, 2018, the Third Circuit denied PDVSA's petition for a writ of mandamus, but vacated that denial on November 23, 2018 in granting a petition for rehearing from PDVSA. The Third Circuit also ordered that "all proceedings" in the district court be stayed "pending the . . . disposition of the petition for writ of mandamus."

In a letter to the district court dated November 26, 2018, Crystallex revealed that it had entered a settlement agreement with Venezuela back in September pursuant to which Venezuela would make an initial upfront payment of \$425 million, after which Crystallex would seek a temporary stay of its enforcement proceedings (i.e., the PDVSA attachment proceedings) to allow Crystallex and Venezuela to finalize payment terms for the remaining amounts owed to Crystallex. Crystallex further revealed that, on November 23, 2018 (the same day the Third Circuit granted PDVSA's petition for rehearing), Crystallex received the final installment of the \$425 million payment. Noting that the Third Circuit had already stayed proceedings in the district court, Crystallex requested that the district court "further stay" enforcement proceedings through January 10, 2019, adding that – if certain additional conditions are not met – it may be necessary to recommence enforcement proceedings.

Crystallex noted further in its November 26, 2018 letter that it expected PDVSA, in light of the settlement agreement between Venezuela and Crystallex, to seek a stay of its appeals to the Third Circuit. To date, PDVSA has not requested such a stay.

This matter may continue to evolve with further motions, rulings, or other

developments. Those interested in the proceedings should continue to monitor the public filings and other available materials.

### **EFFECTS OF THE ORDER ON THE COMMODITY COMMERCIAL AND TRADING COUNTERPARTIES OF PDVSA AND CITGO**

There are many types of commodity commercial and trading contracts that a counterparty could have with PDVSA and/or CITGO (the Venezuelan-owned entities), including but not limited to:

- Commodity purchase and sale agreements;
- Commodity storage agreements;
- Commodity operations (or services) agreements; and
- Commodity facilities agreements.

We refer to these contracts, collectively, as commodity contracts.

One key question the industry is asking: what is the order's effect on counterparties that have commodity contracts with the Venezuelan-owned entities? The answer may vary, depending on the circumstances. However, here are some helpful questions and answers to consider. Parties dealing with any such Venezuelan-owned entities should ensure adherence to any applicable sanctions or other compliance laws.

### **QUESTION: CAN I REQUEST ADEQUATE ASSURANCE THAT THE VENEZUELAN-OWNED ENTITIES WILL CONTINUE TO PERFORM THEIR COMMERCIAL OBLIGATIONS?**

#### **ANSWER:**

Yes. It is reasonable to question whether the order impacts the Venezuelan-owned entities' ability to perform their obligations.

Commodity contracts impose an obligation on each party to ensure that the other party's expectation of receiving due performance will not be impaired. According to the Uniform Commercial Code (the "UCC," which governs the sale of goods in most U.S. jurisdictions), the essential purpose of a contract between commercial parties for goods is not merely a promise but actual performance. Reliance and security that the promised performance will be forthcoming when due is an important feature of the bargain. If either the willingness or ability of a party to perform declines materially between the time of contracting and the time of performance, then the other party is threatened with the loss of a substantial part of what it has bargained for. In these

situations, the threatened party may ask for adequate assurance of due performance and may suspend its own performance until it receives such assurance. If the commodity contract does not specify which actions constitute adequate assurance, then adequate assurance is determined according to commercial standards. In commodity contracts for the sale of goods, some examples of adequate assurance include, but are not limited to, letters of credit, prepayment and/or parent company guarantees.

One request from a counterparty for adequate assurance may not be troublesome. However, multiple requests could act like a bank run and lead to issues in the marketplace: eventually, the Venezuelan-owned entities might not be able to provide adequate assurance to every counterparty, nor would the entities be able to enter into new transactions.

It is recommended that you review the adequate assurance provisions of your contracts with the Venezuelan-owned entities to determine any next steps. Due to the compounding nature of this situation, time is of the essence. Please note that the UCC's rules applicable to requests for adequate assurance apply only to contracts for the sale of goods or hybrid contracts where the sale of goods is a key feature. It does not apply to purely service or other contracts not related to the sale of goods.

**QUESTION: CAN I STOP PERFORMING MY OBLIGATIONS UNDER ANY COMMODITY COMMERCIAL AND TRADING CONTRACTS?**

**ANSWER:**

The answer is that it depends on the type of contract and which U.S. state laws govern the contract. For example, if the contract is for the purchase and sale of a commodity and it is governed by New York's UCC, you may be able to suspend performance if there is a reasonable belief that you will not be compensated for your performance. This course of action, however, should not be taken without a review of the contract from both a legal and a commercial perspective. Pursuing a course of action such as this could ruin a commercial relationship. Before stopping performance of any obligations under a commodity contract with the Venezuelan-owned entities, prudent companies will consult with both legal counsel and the relevant commercial parties.

**QUESTION: CAN I RELY ON ANY CREDIT ENHANCEMENT PROTECTIONS IN MY CONTRACTS?**

**ANSWER:**

The potential outcome will depend on the size and type of the credit enhancement and the nature of the commodity contract.

Credit enhancement protections are utilized to improve a counterparty's credit-worthiness. Commodity contract counterparties often include credit enhancements with their contracts in structuring the transactions to reduce the risk profile associated with a counterparty. By using prepayments, letters of credit and/or parent company guarantees, the seller is reassured that the buyer will honor its obligation to pay and the buyer is reassured that the seller, will deliver or perform.

Traditional credit enhancements associated with a particular commodity contract (other than prepayments, which are always desirable) may no longer be sufficient to reduce the risk of such transaction to an acceptable level.

A prudent approach would be to review the credit enhancement protections for your transactions with the Venezuelan-owned entities to ensure the credit risk profile for such transaction remains acceptable.

**QUESTION: WHAT IS THE STATUS OF ANY WAREHOUSEMAN'S LIEN THAT I MAY HAVE ON COMMODITIES STORED UNDER COMMODITY CONTRACTS WITH THE VENEZUELAN-OWNED ENTITIES?**

**ANSWER:**

In situations of nonpayment and/or nonperformance, these types of liens and the rights associated with them may need to be exercised to ensure payment and performance.

In commodity contracts under which counterparties deliver the commodity to a storage operator (or warehouseman), the commodity may become subject to a lien. A lien is a security right which gives the warehouseman rights over the commodity that can take precedence over the rights of others, among them the owner of the commodity. The warehouseman is entitled to exercise the lien when he is left unpaid for services rendered and in so doing will gain legal control over the goods. This may prevent the owner from disposing of the goods or any financing bank from realizing the value of the goods, in cases where the goods are used as collateral for a loan. It is important to understand

when and against whom the lien can be exercised, particularly when one of the parties may become insolvent.

We suggest that you review any commodity contract that may have a storage component to determine the status of any lien created by such contract. In addition to understanding any rights to call for adequate assurance, this review will prepare you in the case you are considering further steps in the face of non-payment or non-performance.

## CONCLUSION

The ultimate impact of the *Crystallex* order is unknown. However, businesses that may have entered into a commodity contract with the Venezuelan-owned entities should consider, at a minimum, reviewing those contracts to understand their parameters and better plan to maximize protection and mitigate risk.

## UPDATE

Since the initial writing of this article, additional activity has occurred, though no substantive rulings have been issued.

First, despite the district court's invitation to PDVSA to post a supersedeas bond to stay enforcement of the attachment pending appeal, PDVSA has not posted a bond. Instead, PDVSA has asked the district court to stay the post-judgment proceedings pending the appeal without requiring it to post a bond. This request seeks similar relief to the request for stay previously filed by the Citgo entities. As of the time of this update, no ruling has been issued and the attachment process outlined in the attachment order has not yet been enforced by the district court.

Second, in addition to PDVSA's previously filed notice of appeal in the Third Circuit Court of Appeals, PDVSA has also filed a writ of mandamus to that same court challenging, among other things, the district court's exercise of jurisdiction over it. The judgment creditor has now responded to that filing.

Third, the Delaware district court has set a hearing on the various open issues for December 2018.