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INSIGHTS

International Sanctions And The Energy Sector – Part 3: Venezuela

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*By: **Robert Meade** and **Joshua C. Zive***

In the ***first*** and ***second*** parts of this three part series we explored the impact of the international sanctions targeting the Iranian and Russian energy sectors.

In the third part of this series, we consider the sanctions that have been imposed by the US on Petróleos de Venezuela, S.A. ("**PDVSA**"), the Venezuelan state-owned national oil company which accounts for about 98 percent of Venezuela's export revenues.[1] The sanctions on PDVSA are less stringent than those on the Iranian or Russian energy sectors, but still merit consideration.

VENEZUELA

Background

Venezuela has been a key player in the oil industry since the 1920s and is a founding member of OPEC. In 2017 it had the largest proven oil reserves in the world, the majority of which are to be found in Venezuela's Orinoco Belt.[2]

A political and humanitarian crisis in Venezuela led the US to impose sanctions on the Venezuelan government in 2015. These took the form of blocking sanctions, preventing the targeted individuals within Nicolás Maudro's government from doing business with the US.

In August 2017, the scope of the US sanctions were extended to impact the activities of PDVSA and, therefore, the revenue of the Government of Venezuela itself. Further sanctions were imposed by the US in 2018, following Venezuela's attempts to use digital currencies to circumvent the existing US sanctions and the escalating political and humanitarian crisis.

The EU has also imposed sanctions on Venezuela, but these do not target PDVSA or the Venezuelan energy sector.

This article considers the sanctions affecting the activities of PDVSA, which is the largest player in the Venezuelan energy sector.

The Sanctions on PDVSA

The US sanctions against PDVSA are contained in Executive Order 13808 of 24 August 2017 and Executive Order 13835 of 21 May 2018 (the "**Executive Orders**").

The Executive Orders prevent certain transactions from being undertaken by US persons.[3] The restricted transactions include all transactions related to, the provision of financing for, and other dealings in:

1. new debt with a maturity of greater than 90 days of PDVSA;[4]

2. bonds issued by the Government of Venezuela prior to 25 August 2017;[5]

3. dividend payments or other distributions of profits to the Government of Venezuela from any entity owned or controlled, directly or indirectly, by the Government of Venezuela;[6]

4. the purchase of any debt owed to the Government of Venezuela, including accounts receivable;[7]

5. any debt owed to the Government of Venezuela that is pledged as collateral after the effective date of this order, including accounts receivable; and[8]

6. the sale, transfer, assignment, or pledging as collateral by the Government of Venezuela of any equity interest in any entity in which the Government of Venezuela has a 50 percent or greater ownership interest.[9]

In addition, it is prohibited for US persons to purchase, directly or indirectly, securities from the Government of Venezuela (other than securities qualifying as new debt with a maturity of less than, or equal to, 90 days in respect of PDVSA).[10]

In the Executive Orders, the "Government of Venezuela" is defined as including PDVSA. There are, therefore, wide reaching sanctions affecting the ability of US persons to deal with the debt or equity of PDVSA. Furthermore, non-US persons could face enforcement action if they cause a US person to breach these sanctions or cause such a breach to occur within the US.

In July 2018, the US Office of Foreign Assets Control (OFAC) granted a waiver in respect of "*all transactions related to, the provision of financing for, and other dealings in the Petroleos de Venezuela SA 2020 8.5 Percent Bond that would be prohibited by Subsection 1(a)(iii) of Executive Order 13835*".[11] OFAC's rationale is that, without the waiver, holders of the PDVSA 2020 bond would not be able to enforce their security in respect of PDVSA's shares in its US subsidiary Citgo Holdings Inc. The relevant OFAC FAQs note that "*Authorizing bondholders to enforce rights related to the PDVSA 2020 8.5 percent bond prevents the Maduro regime from using the [Executive Order] to default on its bond obligations without consequence*".[12]

The Reaction of Energy Companies

The US sanctions on Venezuela's energy sector are less stringent than those imposed on Russia and Iran. They do not directly target the oil industry and fall short of restricting certain types of exploration and production or acting as an embargo on oil exports.

This is likely to have been deliberate. The US imports significant quantities of Venezuelan oil, which is then refined in US refineries. Thus, restricting the export of Venezuelan oil is unlikely to be in US interests. Also, despite having the world's largest proven reserves in 2017, Venezuelan production has consistently fallen over the last 10 years, long before the sanctions came into force.

It seems, therefore, that it is the oil price and the political climate that has had the greatest impact on the companies operating in the Venezuelan energy sector, not the US sanctions.

Looking Forward

Given the size of Venezuela's proven reserves and the amount of Venezuelan crude oil that is exported to, and subsequently refined in the US, it seems unlikely that more stringent sanctions would be imposed on the Venezuelan energy sector (the most recent US sanctions, imposed in November 2018, target the Venezuelan gold sector). It is nonetheless important for companies operating in the sector to remain updated on the sanctions position and to ensure proper compliance.

Irrespective of any sanctions, the political climate and the cost of doing business in Venezuela may deter energy companies from operating in the country - especially if the significant resources discovered in neighbouring countries (such as Guyana) can be economically exploited.

Conclusion

The extent of the international sanctions imposed on the energy sectors of certain countries has significantly increased since the turn of the decade. This should come as no surprise. Many of the countries that are the subject of international sanctions derive significant revenues from their energy sector, particularly in the exploration, production and export of oil and petroleum products. By targeting such sectors, the proponents of sanctions aim to exert maximum economic pressures.

In this series we have considered the international sanctions targeting the energy sectors of Iran, Russia and Venezuela. The three sanctions regimes differ in scope and there is also divergence in approach between the US and the EU.

The success of these sanctions regimes has arguably been mixed. The 2012 sanctions on Iran could be viewed as successful, at least insofar as they resulted in Iran making concessions on its nuclear programme and agreeing to the JCPOA. Conversely, the sanctions applied to the Russian and Venezuelan energy sectors appear not to have had a significant direct impact on their economies nor furthered the political objectives underlying the sanctions. The fall in oil prices since 2014 and other regional and political issues appear to have had far greater effects. Only time will tell whether the re-imposition of sanctions on Iran by the US following its withdrawal from the JCPOA will be heralded as a success.

It should also be remembered that sanctions do not operate in a vaccum. The re-imposition of sanctions on Iran considered in part 1 of this series, for example, was expected to lead to increased oil prices. However, as a result of other factors including US waivers in respect of the export of Iranian oil to certain countries and increased production by Saudi Arabia, that has not transpired. This underlines that sanctions are but one factor affecting the performance of a country's energy sector and the global oil price. The landscape is forever changing.

On any view, the international sanctions considered in this series (along with the large number of other international sanctions regimes that have not been considered) have increased the compliance burden and, therefore, the cost of doing business both in countries facing sanctions and elsewhere. The extra-territorial reach of the US sanctions in particular means that energy sector participants outside the US jurisdiction must take steps to satisfy themselves that their operations do not breach US sanctions or risk themselves becoming sanctions targets. The non-harmonised approach to sanctions that is now appearing as a result of transatlantic policy divergence, particularly the tension between the US sanctions on Iran and the EU's attempts to save the JCPOA (for example, by way of the EU Blocking Regulation), only serve to complicate matters further.

What is clear is that penalties for breaching sanctions are severe. Energy sector participants should therefore focus on compliance at an early stage so as to mitigate the sanctions risk to their business to the greatest extent possible.

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[1] ***https://www.opec.org/opec_web/en/about_us/171.htm***.

[2] ***https://www.bp.com/content/dam/bp/en/corporate/pdf/energy-economics/statistical-review/bp-stats-review-2018-full-report.pdf***.

[3] US persons are defined as "any United States citizen, permanent resident alien, entity organized under the laws of the United States or any jurisdiction within the United States (including foreign branches), or any person in the United States" (Section 3(c) of Executive Order 13808).

[4] Section 1(a)(i) of Executive Order 13808.

[5] Section 1(a)(iii) of Executive Order 13808.

[6] Section 1(a)(iv) of Executive Order 13808.

[7] Section 1(a)(i) of Executive Order 13835.

[8] Section 1(a)(ii) of Executive Order 13835.

[9] Section 1(a)(iii) of Executive Order 13835.

[10] Section 1(b) of Executive Order 13808.

[11] General License No. 5 to Executive Order 13835.

[12] OFAC FAQ 595.