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Understanding US sanctions on Venezuela

BY JUDITH ALISON LEE, CHRISTOPHER TIMURA AND SCOTT TOUSSAINT

The US sent shockwaves through the international oil, gas and financial markets on 28 January 2019, when it sanctioned Venezuela's state-owned oil company Petroleos de Venezuela, S.A. (PdVSA). This action, which represents the most stringent sanctions imposed on Venezuela to date, is especially noteworthy because it targets not just the most significant actor in Venezuela's oil-dependent economy, but also an entity whose commercial operations are deeply intertwined with the US and international petroleum markets. It is, therefore, imperative that compliance-minded financial institutions involved with, or based in, Venezuela understand both the current scope of US sanctions and, given the fluid situation on the ground in Caracas, where US sanctions policy is likely headed next.

Prior to designating PdVSA, the US had generally taken an incremental approach to imposing sanctions on the regime of Venezuelan president Nicolás Maduro. For example, the US has, at various points, designated senior Venezuelan government officials, including president Maduro, as well as the country's vice president, first lady, defence minister and members of the Supreme Court of Justice. As a result, US persons are generally prohibited from engaging in transactions with these individuals and any assets owned or controlled by these individuals that come within US jurisdiction are frozen.

From a policy standpoint, US sanctions targeting Venezuela have typically been designed to accomplish three main goals: (i) cutting off sources of financing for the Venezuelan state; (ii) preventing president Maduro's inner circle from enriching themselves at the expense of the Venezuelan people; and (iii) sanctioning those deemed responsible for actions or policies which undermine democratic processes or institutions and significant acts of violence or other conduct that harm or violate human rights.

In an effort to constrain the Maduro regime's access to capital, in August 2017 the Trump administration began targeting certain financial instruments issued or sold by the government of Venezuela. The 'government of Venezuela' is broadly defined to include not only its political subdivisions, agencies and instrumentalities, but also the Central Bank of Venezuela, PdVSA and any entity that is at least 50 percent owned or controlled by these targeted entities. Absent authorisation from the US Department of the Treasury's Office of Foreign Assets Control (OFAC), US persons are generally prohibited from: (i) engaging in transactions involving new debt owed by the government of Venezuela with payment terms greater than 30 or 90 days, depending on the debtor; (ii) new equity of the government of Venezuela; (iii) bonds issued by the government of Venezuela; (iv) 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; and (v) the purchase of securities from the government of Venezuela.

Shortly following president Maduro's May 2018 re-election, in a contest that critics have described as a 'sham' and 'neither free nor fair', the US built on the existing measures by prohibiting US persons from engaging in certain transactions involving debt owed to the government of Venezuela, as well as certain transactions involving the equity of Venezuelan state-owned entities. The logic behind those additional measures was to prevent the Maduro regime from using accounts receivable financing to support its continued operations, and also to prevent the regime from selling off valuable state-owned assets in 'fire sales', which would deprive the Venezuelan people of assets that will be vital to rebuilding the country's economy.

Other measures imposed by the US during 2018 include a warning against transacting in Venezuela's new cyber currency – known as the petro – as well as new sanctions targeting Venezuela's gold sector and corruption in Venezuelan government projects and programmes.

It is against that backdrop of narrowly tailored, gradually expanding sanctions that the US, in January 2019, went significantly further and designated PdVSA, a major, multi-billion dollar company, to the Specially Designated Nationals and Blocked Persons (SDN) List, which is administered by OFAC. The announcement came just days after the Trump administration declared president Maduro's recent re-election illegitimate and recognised Juan Guaidó, the head of Venezuela's National Assembly, as the country's interim leader.

Given the company's scale and its deep ties to the US economy, the designation of PdVSA set US and international investors scrambling to understand what activities involving PdVSA remain permissible and which activities could potentially give rise to US sanctions exposure. In that respect, a few key points are worth keeping in mind.

By virtue of being added to the SDN List, all of PdVSA's property and interests in property that are subject to US jurisdiction are frozen and US persons are, except as otherwise authorised by OFAC, generally prohibited from engaging in transactions with PdVSA and its majority-owned subsidiaries.

Additionally, as a general matter, US sanctions on Venezuela only apply to US persons. However, non-US persons dealing with Venezuela risk US sanctions exposure under four particular sets of circumstances. First, with respect to any activities they undertake that have a US nexus. For these purposes, a US nexus might exist, for example, where a non-US person is physically present in the US, purchases goods or services from a US counterparty or clears a US-dollar denominated transaction through a US financial institution. Second, by providing material support, financial, technical or otherwise, to a sanctioned person or entity, such as PdVSA. This is a high bar, typically requiring some sort of intentional effort to assist a sanctioned entity in conduct that OFAC sanctions are intended to curtail, for example acts of public corruption or anti-democratic behaviour. Third, non-US persons can 'cause' a US financial institution to violate its own sanctions compliance obligations by processing funds that originated from a sanctioned person through the US financial system. While the sanctions-related risks of doing business in Venezuela are generally relatively low for non-US persons, these sources of liability are worth at least keeping in mind for a non-US investor considering engaging with PdVSA or one of its subsidiaries.

The designation of PdVSA is also not the end of the story. US sanctions on Venezuela have continued to evolve in early 2019, albeit through a series of narrow, incremental steps. For example, on three separate occasions the US has designated Venezuelan officials for their support of president Maduro and their role in blocking shipments of humanitarian aid. Among the individuals designated are the current president of PdVSA, the governors of four Venezuelan states and various members of the intelligence and security services. Given the steadily expanding number of SDNs in the country, investors would be well advised to regularly screen all potential Venezuelan counterparties against applicable sanctions lists and to exercise particular caution when dealing with individuals closely affiliated with the Venezuelan state.

What lies ahead? US vice president Mike Pence strongly indicated in a 25 February speech before representatives of more than a dozen Latin American countries that additional waves of US sanctions are likely to follow for so long as president Maduro remains in power. While the US has already deployed one of its most powerful economic tools by adding PdVSA to the SDN List, other options remain available, including designating ever larger numbers of senior Venezuelan officials and conceivably designating the entirety of the government of Venezuela. In any case, investors considering doing business in Venezuela should be mindful that a steadily growing number of actors inside the country may become subject to US sanctions over the weeks and months ahead. ■