

Everything you ever wanted to know about PDVSA 2020s (and were afraid to ask)
February 3, 2025

The Tearsheet

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| <ul style="list-style-type: none"> ▪ On January 17, the initial round of briefings in the 2020 Notes case concluded, presenting comprehensive arguments and evidence regarding the validity of the Notes under Venezuelan constitutional law. | Feb 14 | Final day to present bids in the Delaware case |
| | Mar 18 | Briefing on Venezuelan law is due. |
| | Jul 22-24 | Auction sale process |
| | Sep | Southern District Court rules on the Venezuelan law issue. |
| | Oct/Dec | Delaware Court rules on the auction sale |
- Although much of the arguments and evidence resemble those from the initial trial, some new factors might prompt the Southern District Court to reconsider its approach this time.
 - Notably, the Southern District Court and the Second Circuit have framed the case differently. Judge Failla may also reconsider the validity argument under Venezuelan constitutional law to avoid potential conflicts.
 - If the Notes are deemed invalid, the Court may still find the indenture and pledge contract enforceable. Even if those contracts are ruled unenforceable, bondholders could still receive compensation, though as unsecured creditors.
 - The 2020 Notes case will run in parallel with the Delaware case. Although the invalidity issues may be resolved before the Delaware Court rules on the sale, any successful bidder acquiring the shares will likely face the ongoing 2020 case, possibly on appeal.

1. The 2020s and Invalidity Quest

- The PDVSA 2020 case presents unique aspects within the realm of public debt litigation in foreign courts. At its core is the interaction between Venezuelan constitutional law and the choice-of-law clause, which applies New York law to the indenture and pledge agreements.
- PDVSA had previously engaged in several debt transactions, including swaps, that did not require prior parliamentary approval under Venezuelan law. However, in September 2016, PDVSA announced an unusual swap—not due to its financial conditions but because it offered 50.1% of Citgo Holding, Inc. shares as collateral. This marked the first time PDVSA issued secured debt backed by Citgo shares.
- Shortly after the exchange offer was revealed, the opposition-controlled National Assembly passed a resolution ambiguously questioning the validity of using Citgo as collateral. The resolution cited provisions such as Article 187.9 of the Venezuelan Constitution, which grants the National Assembly authority to approve contracts of national public interest. Despite this, PDVSA proceeded to sign the contracts in October 2016.
- The September resolution was part of the broader political conflict between the National Assembly and the Maduro government. Media outlets, including the *Financial Times*, reported concerns over the transaction's legality, with statements like, “lawyers question the legality of the proposed swap.”
- The issue of the transaction’s validity was not immediately raised, as PDVSA, despite being in selective default, continued to meet its financial obligations under the 2020 contracts. However, the invalidity argument resurfaced when PDVSA’s representation shifted to the Interim Presidency in February 2019.

- In October 2019, leveraging the three-month suspension of General License 5 granted by the Trump administration, PDVSA and PDV Holding—represented by boards appointed by the Interim Government—filed a lawsuit in the Southern District Court of New York (SDNY). They argued that the indenture and pledge agreements were null and void due to violations of parliamentary control over contracts involving national public interest.
- According to the ad hoc board of PDVSA at the time, the lawsuit was intended as an emergency measure to preserve Citgo after failed negotiations with noteholders. However, what was initially meant to be a temporary judicial solution has turned into a complex litigation process that has now lasted more than five years.

2. Live from New York: the Venezuelan Constitution

- The New York choice-of-law provisions initially challenged the issue of invalidity. The defendant argued convincingly that the indenture and pledge agreements were valid and binding under New York law, as Venezuelan constitutional law regarding national public interest contracts was not applicable.
- In an opinion dated October 16, 2020, Judge Failla ruled that, under New York law, the constitutional provisions on national public interest contracts were irrelevant to the case.
- The SDNY interpreted Section 8-110 of the Uniform Commercial Code (UCC), which states that the issuer's law governs the validity of a security. According to Judge Failla, "validity" referred only to the authority to issue securities, not the procedure through which the 2020 Notes were issued.
- However, on appeal, the Second Circuit disagreed with this interpretation. On October 13, 2022, it requested clarification from the highest court of New York on whether Section 8-110 should be interpreted more broadly.
- On February 20, 2024, the New York Court of Appeals ruled that Section 8-110 governs both the authority and the procedures allowing the issuer to issue securities. The court concluded that the constitutional provisions governing public national interest contracts are integral to determining the validity of the Notes.
- As Aurora [reported](#) at the time, this ruling marked a significant shift, redefining the interaction between the issuer's constitutional law and the choice-of-law clause. Regarding the 2020 Notes, the Court of Appeals clarified that the validity of the indenture and pledge agreements must be assessed under Venezuelan constitutional law provisions related to national public interest contracts.
- Consequently, the Second Circuit granted the appeal and remanded the case to the SDNY to reassess the validity of the agreements based on Venezuelan constitutional law.

3. The Guidelines of the Second Circuit

- The Court of Appeals judgment left only one possible outcome: granting the appeal, which the Second Circuit did on July 3, 2024. In its judgment, the Second Circuit provided two key procedural guidelines for the SDNY:
 - a) The SDNY must first determine whether PDVSA violated Venezuelan constitutional law by signing the indenture and pledge agreement without the authorization of the National Assembly.
 - b) If the Notes are found valid under Venezuelan constitutional law, the SDNY should resolve the case by applying the act-of-state doctrine, which requires

U.S. courts to honor official acts carried out by foreign governments within their jurisdiction.

- According to these guidelines, the Notes could be deemed invalid either (i) through an interpretation of Venezuelan constitutional law or (ii) under the act-of-state doctrine.
- However, any consequences resulting from invalidity are governed by New York law, as outlined in Section 6.

4. Anatomy of the Case

- After the Second Circuit granted the appeal and remanded the case, Judge Failla issued an order on August 20, 2024, outlining the process for deciding the case. As Aurora has previously [explained](#), the Court will first evaluate Venezuelan law, with new briefings scheduled to conclude by March 2025.
- The first round of briefings concluded on January 17, with both sides submitting arguments supported by reports on Venezuelan law. While much of the content mirrors the arguments from the initial trial, PDVSA has sought to introduce new perspectives to strengthen its case.
- PDV Holding presented arguments asserting that (i) the indenture and pledge agreements qualify as national public interest contracts under Venezuelan law, requiring prior approval from the National Assembly (ECF No. 343), and (ii) the resolutions passed by the National Assembly in March and September 2016, as well as October 2019, should be interpreted through the act-of-state doctrine, limiting their impact to within Venezuela. An affidavit from the former chairman of the National Assembly's comptroller commission supported this position, emphasizing that the September 2016 resolution raised questions about PDVSA's authority due to parliamentary oversight of national public interest contracts.
- Two expert reports from Professors Allan R. Brewer-Carías (ECF No. 340) and José Araujo Juárez (ECF No. 342) reinforced these arguments. Brewer-Carías's report largely reiterates prior points, while Araujo's report introduces new insights into the constitutional aspects of the case, addressing issues raised during the first trial.
- The Republic of Venezuela filed a statement (ECF No. 326) similar to the one previously dismissed by the Court during the initial trial. In addition to legal arguments, the statement referenced the illegitimacy of the Maduro regime, particularly following the 2024 presidential election.
- The defendants repeated key arguments from the first trial, claiming that (i) the indenture and pledge agreements do not qualify as national public interest contracts requiring National Assembly approval, and (ii) the act-of-state doctrine does not apply to the National Assembly's resolutions. The defendants, citing the October 2020 opinion, maintained that the September 2016 resolution did not challenge the transaction and that the October 2019 resolution should not be considered binding due to its extraterritorial nature (ECF No. 347). These points were supported by a sealed Venezuelan law report.
- The defendants also presented a new perspective, arguing that even if the Notes are deemed invalid, the 2020 Notes contracts should remain enforceable under Venezuelan law to protect legitimate expectations. They contended that because PDVSA executed and fulfilled the contracts between 2016 and 2019, noteholders should be entitled to protection.
- The October 2020 opinion suggested that Judge Failla had anticipated questions related to the constitutional basis of the national public interest contract rules affecting PDVSA. The opinion further indicated that the September 2016 resolution, while falling under the act-

of-state doctrine, did not dispute the constitutionality of the Notes. The October 2019 resolution was seen as a subsequent ruling with potential implications for expropriation. Based on these considerations, the SDNY could potentially dismiss the validity issue.

- Although the full briefing process is still ongoing, making it too early to fully assess the strength of these arguments, the inclusion of new Venezuelan legal perspectives could lead Judge Failla to reconsider her initial views on the case.

5. Framing the Case: Judge Failla v. the Second Circuit

- There is a key difference between how the October 2020 opinion framed the case and the Second Circuit's narrative.
- According to the 2020 opinion, the National Assembly never explicitly challenged or prohibited the swap, meaning PDVSA did not violate any binding decision. However, in its appeal, the Second Circuit framed the case as part of the broader political struggle between Maduro and the opposition-led National Assembly.
- As previously [discussed](#) by Aurora, the Second Circuit reaffirmed this narrative when ruling on the VR Global case, involving a 2020 noteholder suing PDVSA for fraud. In its decision, the court described the 2020 Notes as having been issued despite the National Assembly's "categorical rejection of the exchange offer."
- This shift in narrative could motivate Judge Failla to more thoroughly consider the arguments based on Venezuelan constitutional law. It also raises the likelihood that the Second Circuit will grant an appeal if Judge Failla dismisses the case using the same reasoning as in the 2020 opinion.

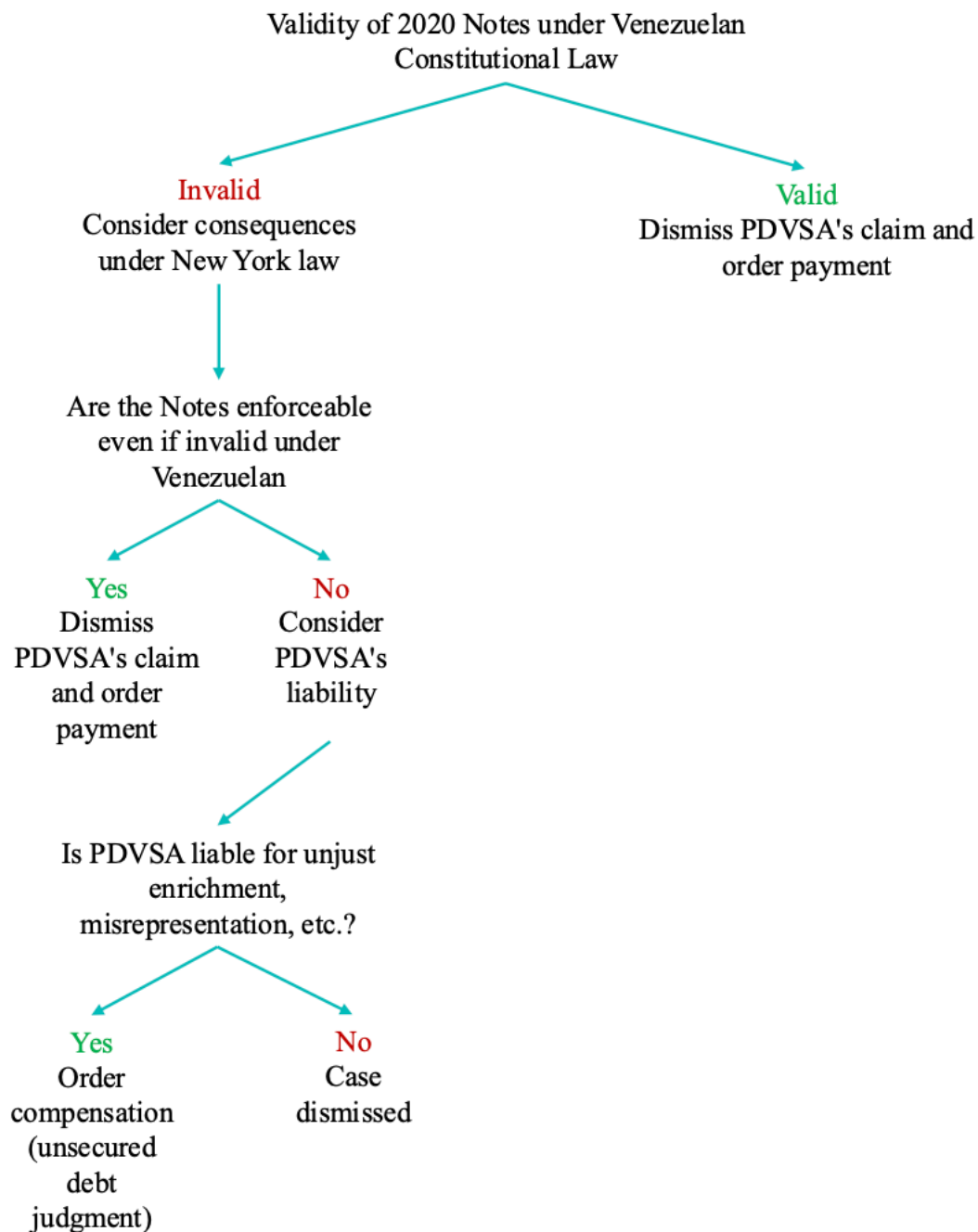
6. Judge Failla's Decision Tree

- Based on the Second Circuit judgment granting the appeal and the August 2024 order by the SDNY, we can summarize the decision-making process as follows:
 - A. The first decision concerns the validity of the 2020 Notes under Venezuelan constitutional law, which is the issue currently under review.
 - a) If the Notes are deemed valid, the Court will likely dismiss PDVSA's claim and order the payment of the outstanding amount (consistent with the October 2020 opinion).
 - b) If the Notes are deemed invalid, the Court will likely consider the legal consequences under New York law.
 - B. The second decision under New York law addresses whether the Notes, even if invalid under Venezuelan law, are still enforceable.
 - a) If the Court concludes that the Notes are enforceable, it will likely dismiss PDVSA's claim and order payment of the outstanding amount (similar to the October 2020 opinion).
 - b) If the Notes are deemed unenforceable, the Court may consider whether PDVSA bears any liability.
 - C. Even if the Notes are not enforceable, the Court could evaluate whether PDVSA is liable for unjust enrichment, misrepresentation, or other similar claims.



- If the Court finds PDVSA liable, it could order compensation, which would be classified as unsecured debt based on a judgment.
- If the Court finds PDVSA not liable, the case will be dismissed.

Legal Decision Process for PDVSA's 2020 Notes Case



7. The 2020s before the Delaware Court

- The auction sale process and the new 2020 Notes trial will run concurrently, meaning any final decisions could be issued around the same time.
- Under the new rules governing the auction's sale hearing, as previously [explained](#) by Aurora, the Delaware Court has decided not to implement any measures to protect the 2020 noteholders' rights. As a result, bidders will need to assess and bear the risks associated with the 2020 Notes.
- The Venezuelan legal issue may remain unresolved when the auction sale is scheduled for late July. However, the SDNY is expected to rule on the validity issue before Judge Stark concludes the auction sale process.
- Any new bids will be submitted while the Venezuelan constitutional law issue remains unsettled, requiring bidders to carefully evaluate the risks tied to the 2020 Notes. This uncertainty could be one of several factors contributing to lower bids compared to Amber's original USD 7.3 billion proposal.
- If the auction sale proceeds, the new PDV Holding shareholder will need to address the 2020 Notes if they are deemed valid or enforceable. If the Notes are found invalid and uncollectible, any liability for unjust enrichment will fall on PDVSA.



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