

The Many Challenges Facing Venezuela Bribery Suit: Part 1

By **Richard Cooper and Boaz Morag** (April 13, 2018, 12:28 PM EDT)

Last month, we wrote about a lawsuit filed by the PDVSA US Litigation Trust in federal court in Miami on behalf of Venezuela's state-owned oil company, Petróleos de Venezuela SA, or PDVSA.[1] The lawsuit alleges that the defendants, a group of 44 oil trading companies, banks and individuals, participated in a 14-year scheme to rig bids, underpay on purchases and overcharge on sales, allegedly resulting in billions of dollars of losses to PDVSA.

In our prior article, we flagged a number of interesting legal and factual questions raised by the suit, such as how the trust was created, whether it has standing to assert PDVSA's claims, whether some or all of the claims would be barred by applicable statutes of limitation and adequately assert an injury in the United States, and whether the trust would be able to obtain the cooperation from PDVSA necessary to respond to discovery requests, among others.

The case also presents questions as to whether it will have implications for financial creditors of PDVSA, and even creditors of the republic of Venezuela, who may be able to lay claim to the economic value of the trust's lawsuit, or to any recovery, on the theory that the trust is pursuing the claims for PDVSA's sole benefit. The documents that have been filed in the suit thus far provide insight into some, though certainly not all, of the questions raised above and also introduce new issues of their own. This is the first part of a two-part article providing an update on the litigation and the questions we have raised. Part one of this article, below, focuses on issues related to the defendants' challenges to the trust's standing, while part two of this article will focus on other legal issues presented by the litigation.

Current Status of the Litigation

Shortly after filing the action, the trust filed an ex parte motion for a temporary restraining order as to a group of defendants the trust refers to as the "Morillo defendants," alleged to be the conspiracy's ringleaders, which does not include the oil trader or bank defendants. The court granted the temporary restraining order only in part, ordering the Morillo defendants to preserve evidence but denying the trust's request to seize evidence and freeze those defendants' assets. Since then, the trust has served many of the defendants and has continued to pursue via its motion for a preliminary injunction the relief it was denied ex parte. However, it has encountered some difficulty in serving certain of the individual



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defendants and delay in serving the foreign corporations whose countries require service under the Hague Convention.

The defendants who have appeared to date have not only opposed the preliminary injunction, including on grounds that the trust lacks standing, but have also challenged numerous subpoenas the trust served on nonparties and the admissibility of certain statements included in the declarations of the trust's investigators that were publicly filed with the trust's amended complaint filed on March 9, 2018. These challenges have resulted in the court deferring the hearing on the trust's motion for a preliminary injunction. At a status conference on April 4, 2018, the court accepted that the issue of the trust's standing needs to be addressed as a threshold matter. The court has assigned the preliminary discovery issues and the defendants' standing challenge to a magistrate judge for initial consideration at a hearing set for April 16, 2018.

What Has Been Disclosed About the Trust?

Our initial article noted that the complaint was bereft of any details regarding the trust other than that it was a New York trust formed in July 2017. Since then, and without disclosing how it was obtained, the Morillo defendants filed with the court on March 26, 2018, a partially executed copy of the "PDVSA U.S. Litigation Trust Agreement" dated July 27, 2017. On April 2, 2018, the trust's counsel filed a fully executed and slightly different version of that agreement. The version filed by the trust names a different PDVSA-appointed trustee than the version filed by the Morillo defendants, but is also dated July 27, 2017, and otherwise appears to be the same.[2]

The trust agreement confirms that the trust was created "by PDVSA for the sole benefit, and on behalf of, PDVSA." [3] Through the trust agreement, PDVSA irrevocably transferred, assigned and delivered to the trust all of its rights and interests in the claims arising out of the alleged bribery scheme. The agreement also reveals that two weeks before the trust was formed, PDVSA entered into an engagement letter with U.S. counsel (Boies Schiller Flexner LLP and Meister Seelig & Fein LLP) to act as counsel to the trust. [4]

Significantly for purposes of the challenge to the trust's capacity to assert PDVSA's claims, the trust agreement recites that it was entered into by PDVSA "acting in this matter through the Minister of the People's Petroleum Power as a representative duly authorized to take action on behalf of PDVSA" and was executed on behalf of PDVSA by Nelson Martínez, the then-minister of the People's Petroleum Power. [5] Martínez has since been arrested on corruption-related charges. [6] Although not designated as party to the trust agreement, the document was also executed by Reinaldo Muñoz Pedroza, who was at the time and remains Venezuela's Procurador General de la República (attorney general).

The other parties to the trust agreement are the three litigation trustees: the PDVSA appointee, Alexis Arellano Bolívar, Gerente General de Administración (general business manager) of the Ministry of the People's Petroleum Power, and the two appointees of the trust's lawyers, Vincent Andrew of Private Capital Advisors Inc. in New York City and Edward P. Swyer of The Swyer Cos. in Albany, New York. [7] In the version of the trust agreement submitted by the Morillo defendants, the PDVSA-appointed trustee was Miguel Bolívar, the corporate treasury manager at PDVSA. [8]

Although the litigation trustees are generally responsible for managing the trust's assets (including its claims against the defendants and the recoveries on such claims), when it comes to settling any claims, the trustees' decision must be unanimous and must be taken in "consultation with" the Venezuelan attorney general. [9] Any distribution of proceeds to PDVSA is then "subject to the approval of the" attorney general. [10] All notices "to PDVSA" under the trust agreement are to be sent to a legal

consultant within the Ministry of the People's Petroleum Power.[11] PDVSA, however, retained the right to determine, along with the trust's lawyers, the compensation to be paid to the litigation trustees.[12]

As to the financial arrangements underlying the trust, many of those details appear to be contained in the engagement letter, which, although identified as an exhibit to and made a part of the trust agreement, has not been filed with the court by either side. Nonetheless, the trust agreement contains some clues.

First, the trust agreement recites that an entity called "Algamex" "may provide funding to fund the fees, expenses, and costs of the Litigation Trust," but that "[a]ny failure or inability of the Litigation Trust to obtain funding will not affect the enforceability of the Litigation Trust." [13] Second, the trust agreement provides that in "accordance with the Engagement Letter, all expenses of prosecuting the [litigation claims], including payments to all professionals, shall be borne by parties receiving 66% of the Proceeds of the [litigation claims]." [14] The term "proceeds" is defined as "the actual consideration, if any, received as a result of any judgment, settlement, or compromise of any of the [litigation claims], *provided, however*, that, as contemplated in the Engagement Letter, the Litigation Trust shall not receive more than 34% of the final amount of Proceeds." [15]

Thus, it would appear that unlike the more typical structure in contingency fee cases where expenses are advanced by counsel but deducted from gross proceeds before the allocation of the net proceeds between the lawyers and the client, here the trust's lawyers are to receive 66 percent of the gross proceeds to cover their advancement of expenses and their contingency fee interest, with PDVSA, as trust beneficiary, being capped at recovering no "more than 34% more of the final amount of Proceeds."

Defendants' Challenges to the Trust's Standing

The fact that certain of the defendants were able to obtain a copy of the trust agreement facilitated their making a preliminary challenge to the standing of the trust.

The Venezuelan and New York Law Issues

The defendants contend that the trust agreement is null and void under Venezuelan law because: (1) the minister of the people's petroleum power did not have the legal authority to enter into or execute the contract of behalf of PDVSA, and (2) the trust agreement was not approved by the National Assembly, as is required to validate international contracts of Venezuelan public companies. The defendants support their position with a lengthy opinion of a Venezuelan law expert, who argues that under PDVSA's bylaws, only the board of directors of PDVSA has the power to authorize contracts and only the president of the board, with the board's prior authorization, may properly execute those contracts. Because neither the minister of the people's petroleum power nor the attorney general appear to have had prior authorization from the PDVSA board, their actions cannot bind PDVSA and the contract cannot be considered valid to transfer PDVSA's claims to the trust, according to the defendants' expert.

Additionally, the defendants contend, Venezuelan law requires that the National Assembly, Venezuela's legislature, approve all public interest contracts entered into by public companies. The defendants' expert concludes that because PDVSA is a public company and the trust agreement is a public interest contract, it was required to be submitted to the authorization of the National Assembly in order to be valid.

The defendants also challenge the trust agreement under New York law for several reasons. First, they claim that the trust agreement does not comply with the requirements of New York's Estates, Powers and Trusts Law, which governs New York trusts, because its execution by the litigation trustees was not

witnessed or acknowledged by a notary public. Second, the defendants argue that the trust agreement violates the rule against perpetuities. And third, they argue that the property used to fund the trust (PDVSA's litigation rights arising out of the alleged bribery scheme) is too broad and speculative to be accurately identified.

The Trust's Response

The trust's response to date on the standing issues under Venezuelan law relies primarily on the position that the defendants' challenge to the trust's validity is barred by the act-of-state doctrine. The act-of-state doctrine "precludes any review whatever of the acts of the government of one sovereign State done within its own territory by the courts of another sovereign State." [16] Under the doctrine, U.S. courts must generally deem valid any act of a foreign sovereign taken within that sovereign's own jurisdiction. [17]

Because the defendants challenge the power of Venezuelan government officials to enter into the trust agreement, the trust argues that the court is being asked to evaluate the acts of a sovereign that occurred within the borders of Venezuela and constituted public acts of Venezuelan officials. Consequently, the trust argues that the U.S. court is obliged to refrain from questioning whether the trust agreement was validly entered into under Venezuelan law. The trust also disputes the defendants' interpretation of Venezuelan law, and has indicated that it will submit a contrary legal opinion, though it has not yet done so.

The trust has also responded to the defendants' arguments under New York law, including by submitting an acknowledgement form signed by litigation trustees Vincent Andrew and Edward Swyer and notarized on April 2, 2018, confirming that they had signed the trust agreement.

Analysis

The most interesting aspect of the defendants' standing challenge is the issues raised under Venezuelan law, first whether the act-of-state doctrine precludes the Florida court from examining the authority issue at all, and even if it is not precluded from doing so, whether it has another reason not to delve into the intricacies of Venezuelan law.

Though neither side has yet briefed this point, it is significant that the trust agreement includes a New York choice-of-law clause that states: "This Litigation Trust Agreement shall be governed by, and construed and enforced in accordance [sic] the laws of the State of New York, without giving effect to the principles of conflicts of law thereof." [18] This unqualified choice-of-law clause differs from the provision in the republic's bonds, which subjects the bonds to New York law, but states that "Authorization and execution of this agreement by the issuer, however, shall be governed by the laws of the Republic of Venezuela." [19]

The trust agreement further includes a broad arbitration clause requiring that any dispute, including over the "validity" of the agreement, "shall be determined by binding arbitration in New York City." [20] The agreements to apply New York substantive law to all issues of "enforce[ment]" and to arbitrate any disputes between PDVSA and the litigation trustees over the "validity" of the trust agreement in New York have two potential ramifications to the standing debate between the trust and the defendants.

The first ramification is that the election of New York law and of arbitration of disputes in New York undermines any defense based on the act-of-state doctrine. That is because the doctrine applies only to

acts of a sovereign that are taken within the sovereign's borders under color of that sovereign's laws.[21] After all, the doctrine's rationale is to avoid the affront of a U.S. court invalidating the decisions taken by a foreign sovereign within its own territory under its interpretation of its own laws. A corollary to this principle is that act-of-state doctrine also applies only to those acts completed within the physical territory of the foreign state.[22] Here, the express choice by the Venezuelan minister of the people's petroleum power and the attorney general to (a) subject the enforceability of the purported assignment of PDVSA's litigation claims to the trust to New York law and to arbitration in New York, and (b) transfer PDVSA's litigation claims to a New York-domiciled trust for purposes of pursuing those claims in courts outside of Venezuela, render those acts not subject to Venezuelan law and to resolution outside of Venezuela, thereby undermining the essential premises of the act-of-state doctrine.[23]

Second, even if the act-of-state doctrine would not bar looking at the validity of the trust agreement under Venezuelan law, there is a separate question as to whether the court should do so. Ordinarily, where a contract is silent as to choice of law, the question of whether the signatory had the actual authority to bind a foreign state-owned corporation would be decided under the law of that corporation. The trust agreement, however, contains a New York choice-of-law provision. In *IRB-Brasil Resseguros SA v. Inepar Investments*, and *Ministers and Missionaries Benefit Board v. Snow*, the New York Court of Appeals confirmed that a New York choice-of-law provision in an agreement (including an instrument governed by the New York Estates, Powers and Trusts Law) mandates the application of New York substantive law, including to the validity of the instrument and authority of its signatories, even where application of foreign law would yield a different result than applying New York law.[24] Accordingly, although neither party has yet raised the trust agreement's choice-of-law and dispute resolution clauses, the Florida court may determine that although it is not barred by the act-of-state doctrine from considering Venezuelan law, the choice of New York law requires that only the substantive law of New York be applied to decide the issue of the trust agreement's validity.

As a practical matter, it is possible that the court's decision on the trust's validity may be influenced in part by whether PDVSA and/or the National Assembly weigh in on these issues of authority of the Ministry of the People's Petroleum Power to bind PDVSA and the effectiveness of the agreement absent National Assembly approval. The National Assembly is reportedly investigating the execution of the trust agreement for compliance with Venezuelan law. The court could thus receive conflicting views regarding the trust agreement's validity, not just from legal experts hired by the parties, but from PDVSA itself and various persons within the Venezuelan government.

In short, as anticipated in our prior article, the standing issues are complicated in this case and create a significant early hurdle for the trust to overcome if this action is to proceed to the merits.

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[1] Richard Cooper and Boaz Morag, *New Bribery Suit's Implications For Venezuela Restructuring*, Law360 (March 19, 2018).

[2] The trust agreement as submitted by the Morillo defendants is found at Docket Entry 161-1 and the version submitted by the trust can be found at Docket Entry 221-14 in Case No. 1:18-cv-20818-DPG in the United States District Court for the Southern District of Florida, Miami Division.

[3] PDVSA U.S. Litigation Trust Agreement § 2.4.

[4] *Id.*, Art. I.

[5] Trust Agreement, Preamble.

[6] The stated reason for Martinez's arrest was that he allegedly allowed a Citgo refinancing deal to proceed without the approval of the Venezuelan government. See Venezuela's Ex-Oil Minister and Ex-PDVSA Head Arrested, BBC News (Nov. 30, 2017).

[7] *Id.*, § 4.1.

[8] Docket Entry 161-1 at 8, 16.

[9] Trust Agreement § 3.3(a).

[10] *Id.*, § 3.6(a).

[11] *Id.*, § 9.9(b).

[12] *Id.*, §4.4(a).

[13] *Id.*, § 2.3.

[14] *Id.*, §3.5(d).

[15] Trust Agreement, Annex A (emphasis in original).

[16] *First Nat. City Bank v. Banco Nacional de Cuba*, 406 U.S. 759, 763 (1972).

[17] *W.S. Kirkpatrick & Co. v. Env'tl. Tectonics Corp., Int'l*, 493 U.S. 400, 404 (1990).

[18] Trust Agreement § 9.3.

[19] See Fiscal Agency Agreement Among the Bolivarian Republic of Venezuela, Banco Central de Venezuela, Deutsche Bank AG and Bankers Trust Company, dated July 25, 2001, at § 12; Fiscal Agency Agreement Among the Republic of Venezuela, Banco Central de Venezuela, and the Chase Manhattan Bank, dated August 6, 1998, at § 12.

[20] *Id.*, § 9.4.

[21] See *Federal Treasury Enterprise Sojuzplodoimport v. Spirits Intern. BV*, 809 F.3d 737, 743 (2d Cir. 2016). In *Federal Treasury Enterprise*, a Russian state-owned entity brought a trademark infringement action against defendants who allegedly usurped the trademark rights to Stolichnaya® vodka in the United States. The defendants argued that the Russian plaintiff did not have standing to bring the claim

because the Russian government had improperly assigned the intellectual property rights associated with the Stolichnaya mark to the plaintiff. The Second Circuit held that a U.S. court is precluded from examining the validity of an assignment of intellectual property rights by the Russian government to a Russian entity because “the Russian Federation's Decree was the act of a foreign sovereign ... ‘done’ within the boundaries of Russia.” *Id.*

[22] See *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 425 (1964) (“The courts of one independent government will not sit in judgment upon the validity of the acts of another done within its own territory.”).

[23] By contrast, in the Stolichnaya trademark case, the court of appeals found that the validity of the challenged assignment “is a question of Russian law decided within Russia’s borders, rather than a matter of U.S. law with a situs in the United States.” *Federal Treasury Enterprise Sojuzplodoimport*, 809 F.3d at 744.

[24] *IRB-Brasil Resseguros SA v. Inepar Investments SA*, 20 N.Y. 3d 310, 315 (2012) (finding that choice-of-law clause meant New York substantive law applied to determine the validity of a contractual guarantee under General Obligations Law § 5-1401 even though application of Brazilian law would arguably have resulted in the agreement being void for the signatories’ lack of actual authority and affirming validity of the guaranty under the New York law doctrine of ratification). In *Ministers and Missionaries Ben. Bd. v. Snow*, 26 N.Y. 3d 466, 468 (2015), the court of appeals extended the IRB holding “to contracts that do not fall under General Obligations Law § 5-1401 including a retirement plan subject to the EPTL, and clarif[ied] that this rule obviates the application of both common-law conflict-of-laws principles and statutory choice-of-law directives, unless the parties expressly indicate otherwise.”