ENFORCEMENT IN THE UNITED STATES AGAINST ALTER EGOS OF FOREIGN SOVEREIGNS

DEVELOPMENTS ON THE VENEZUELA FRONT

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Introduction

In the United States, when creditors seek to collect on a judgment or award rendered against a sovereign state, instrumentalities of that state are presumptively off limits for enforcement. But, as with most rules, there are exceptions. For example, where the state so extensively controls an instrumentality as to render it an alter ego, or if corporate formalities of an instrumentality are being abused to perpetrate a fraud or similar injustice, courts will disregard corporate formalities for purposes of enforcement.

Currently, the alter ego concept is at the forefront of high-profile ongoing litigation in the federal District Court for the District of Delaware. In Delaware, creditors of the Bolivarian Republic of Venezuela ("Venezuela") are seeking to attach the assets of its national oil company, Petróleos de Venezuela, S.A. ("PDVSA"). This article presents developments in those efforts and offers insights on a federal appellate court's recent approach to the alter ego question in that case.

The Crystallex Proceedings

In 2018, Crystallex International Corporation proved in Delaware District Court that PDVSA was the alter ego of Venezuela, rendering the oil company's United States assets vulnerable to enforcement in relation to Venezuela's debts. Crystallex showed that Venezuela used PDVSA's assets as its own and directed PDVSA to take certain actions to further the government's political ends. That finding opened the door for Crystallex to: (a) attach PDVSA's shares in its United States subsidiary, Petróleos de Venezuela Holding, Inc. ("PDVH"), which in turn is the ultimate owner of CITGO Petroleum Corporation; and (b) commence proceedings that could potentially lead to an auction of PDVSA's shares in PDVH.

Following the 2018 Crystallex decision, other creditors commenced proceedings seeking to attach PDVSA's assets in Delaware to recoup their own judgments against Venezuela and

PDVSA. However, in January 2019, the United States Government withdrew its recognition of the government organised by Nicolás Maduro, (then and now, the de facto President of Venezuela), and instead recognised a government organised by Juan Guaidó as the only legitimate government of Venezuela. In part because of this change, the Delaware District Court refused to give its 2018 decision in the Crystallex case the effect of collateral estoppel, and instead required the new creditors to again prove the alter ego relationship between Venezuela and PDVSA based on the new circumstances concerning the recognised government of Venezuela.

Later, the court would clarify that the "pertinent time" for analyzing the alter ego relationship is "the period between the filing of the motion seeking a writ of attachment and the subsequent issuance and service of that writ."

The court, in so holding, made clear that it would not look at Venezuela's relationship with PDVSA as of the date Venezuela's debt accrued. Nor would the court look solely at the date of the application for an attachment (many applications had been filed before the United States recognised the Guaidó presidency). The creditors had to account for all facts regarding PDVSA and Venezuela as they developed between filing their motions for writs of attachment and the eventual order resolving those motions. As a result, some creditors filed new attachment motions with evidence that PDVSA and Venezuela remained alter egos after 2019—even under the Guaidó administration.

Ultimately, in March 2023, as discussed further below, the post-Crystallex creditors succeeded in establishing that PDVSA remained the alter ego of Venezuela in a case called in OI European Group B.V. v. Bolivarian Republic of Venezuela ("OIEG"). A federal appellate court—the US Court of Appeals for the Third Circuit—affirmed that finding in July 2023. This ruling has greatly expanded the list of creditors seeking to participate in the auction of PDVSA's shares in PDVH.

The Standard For Determining An Alter Ego Relationship Between Foreign Sovereigns And Foreign State Instrumentalities In The US Federal Courts

The alter ego analysis is not laid out by statute, but by federal common law. Specifically, the United States Supreme Court's 1983 decision in First National City Bank v. Banco Para el Comercio Exterior de Cuba ("Bancec") is a key decision governing whether a state instrumentality is the alter ego of a foreign sovereign. In that case, Cuba established Bancec as a state-owned credit institution for foreign trade. Bancec sought to collect on a letter of credit issued by Citibank, and just days later, the Cuban government nationalised and seized Citibank's assets in Cuba and dissolved Bancec. Citibank counterclaimed in Bancec's suit on the letter of credit in US District Court. Ultimately, the Supreme Court held that because Bancec was Cuba's alter ego, Citibank could offset Bancec's claim against it with the value of its assets that Cuba had seized.

The Supreme Court applied principles of equity in deciding not to give effect to Bancec's separate juridical status. The Court refused to apply the law of the state that established the government instrumentality (here Cuba) because doing so "would permit the state to violate with impunity the rights of third parties under international law while effectively insulating itself from liability in foreign courts." And while the Court recognised a presumption that the separate legal personality established by a foreign sovereign should typically be respected, the Court "decline[d] to adhere blindly to the corporate form where doing so would cause … an injustice."

Notably, the Supreme Court did not set out any "mechanical formula for determining the circumstances under which the normally separate juridical status of a government instrumentality should be disregarded." The Court emphasised that its conclusion that Bancec was Cuba's alter ego was "[i] nstead … the product of the application of internationally recognised equitable principles to avoid the injustice that would result from permitting a foreign state to reap the benefits of our courts while avoiding the obligations of international law."

More recently, in its 2018 decision in Rubin v. Islamic Republic of Iran, the Supreme Court distilled Bancec's equitable analysis into several factors to aid the assessment of whether a state instrumentality is the alter ego of a foreign government for purposes of permitting joint enforcement of the foreign state's legal obligations.

These factors include:

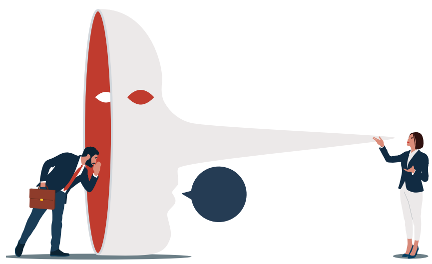
(1) the level of economic control by the government;

(2) whether the entity's profits go to the government,

(3) the degree to which government officials manage the entity or otherwise have a hand in its daily affairs;

(4) whether the government is the real beneficiary of the entity's conduct; and

(5) whether adherence to separate identities would entitle the foreign state to benefits in United States courts while avoiding its obligations."



The Appellate Court's 2023 Alter Ego Decision Affirming PDVSA's Alter Ego Status

In its March 2023 decision in OIEG, the Delaware District Court applied the Rubin factors to find that PDVSA remained the alter ego of Venezuela. The District Court found that an alter ego relationship existed, irrespective of whether one analyzed the question in terms of the relationship of the Guaidó government to PDVSA, the Maduro government to PDVSA, or both.

Inherently, the facts supporting the alter ego analysis for each regime differed slightly. Mr. Guaidó exerted control only over PDVSA's assets in the territories outside of Venezuela that recognised his government. Mr. Maduro, on the other hand, maintained control over PDVSA's assets within Venezuela. When considering the Maduro regime's control over PDVSA, the District Court found that Mr. Maduro had done little to change the conduct supporting the court's 2018 alter ego decision. With respect to the Guaidó government, the District Court found that Mr. Guaidó exerted extensive control over PDVSA within the United States—including using PDVSA's corporate assets to fund his government.

In affirming the District Court's decision in July 2023, the Third Circuit came to two notable conclusions regarding the alter ego analysis:

First, it determined that the actions of the Guaidó and Maduro governments, combined, represented the totality of Venezuela's sovereign relationship to PDVSA. The Third Circuit found that "the relevant 'government' in a Bancec analysis is the foreign country's sovereign, which transcends any administrator," and that a "sovereign" does not change even in the transition of the form and administration of its government.

Second, the Third Circuit clarified the relevant timeframe for examining Venezuela's actions for purposes of the alter ego analysis, concluding that courts "should consider all relevant facts up to the time of the service of the writ of attachment." The Third Circuit explained that this approach avoids "unnecessarily leav[ing] room for manipulation." In this regard, the court drew guidance from the Supreme Court's charge in Bancec that the alter ego analysis should apply equitable principles to avoid fraud or injustice. Specifically, the Third Circuit expressed concern that limiting the factual examination only to "how a state acts after learning that its actions surrounding an instrumentality are under scrutiny" would invite fraud or injustice. For example, a state could "quickly scale back oversight, announce laudable (but long-away) reforms, [and] pass promises of new corporate independence … All while its practices dating back to the injury show an alter ego relationship." Similarly, the Third Court considered that limiting the alter ego inquiry to the time of injury was also inadequate, as "a state determined to avoid creditors might simply drop vulnerable assets into a new instrumentality and thus create juridical entities whenever the need arises."

Conclusion

While the efforts of Venezuela's creditors to seize shares of PDV Holding continue, the Third Circuit's decision in OIEG offers important lessons for creditors pursuing enforcement actions in US courts against foreign state instrumentalities to satisfy a sovereign's liabilities.

The decision reflects the wide latitude accorded to judges under the equitable framework the Supreme Court articulated in Bancec.

Courts should engage in a flexible alter ego analysis that properly takes into account the specific circumstances of each case. Indeed, plaintiff-creditors should take note of the Third Circuit's temporal framework for the alter ego analysis in evaluating changes in a state's relationship with its instrumentalities from the time of injury to the present.