CARLTON FIELDS

Cuba: Risks and Rewards for U.S. Businesses

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Background

Last week, the Obama Administration announced that the President intends to visit Cuba next month. He will find a political mixed bag of optimism and resignation. American businesses will find an equally cloudy picture. U.S. firms have a growing interest in doing business in Cuba. This is largely due to the Obama Administration's loosening of restrictions on, among other things, travel to and trade with and in Cuba, despite the ongoing U.S. trade embargo, which can only be lifted by the U.S. Congress. Furthermore, there has been a certain, albeit restrained, reciprocity from the Cuban government. This paper addresses some of the opportunities and risks associated with doing business with and in the "Pearl of the Antilles." While there are significant opportunities, the risks appear to outweigh the rewards for those operating in most industries. However, for the industries discussed below, there may be both immediate and long-term rewards. **Facts and Recent Developments**

Cuba had a 2015 population of approximately 11.2 million people and is steadily losing population due to emigration. In 2013, Cuba's estimated GDP was U.S. $77.15 billion. Since December 2014, the Obama Administration has been working to build new relationships with the country, which was ruled for more than a generation by communist strongman Fidel Castro. Fidel came to power on January 1, 1959 and ruled the country until 2008, when he turned over control to his brother, Raul Castro. Raul announced he will not serve as president beyond February 2018. Thus far, he has demonstrated a greater willingness to work with the U.S. than his brother. The Obama Administration has loosened

Cuban trade restrictions incrementally. The regulations issued by the U.S. government on January 26, 2016 are the latest development in this process. Among other things, these rules amend the Cuban Assets Control Regulations and Export Administration Regulations to implement the following:

1. Removal of financing restrictions for most kinds of authorized exports and re-exports such that U.S. financial institutions are now able to provide financing for the export of most products.

2. Expansion of general license categories to facilitate travel to and from Cuba.

3. New licensing approval policy whereby the Bureau of Industry and Security (BIS) will generally approve license applications for the export and re-export of commodities, software, and telecommunications items to the Cuban people, thereby exposing the country to more American goods, people, and ideas.

4. License applications for the export of items that have been banned for decades because they might be beneficial to the Cuban government (*e.g.*, textbooks, sanitation equipment and construction cranes) can now be approved by the BIS on a case-by-case basis.

5. Loosening travel restrictions to facilitate re-establishment of direct flights and for Americans traveling to Cuba to make films, record music, organize professional meetings and athletic competitions, or work on cruise ships or airliners.

Although these amendments removed major impediments to contact between the United States and Cuba, the question remains as to how useful they will be for American businesses. Exports to Cuba will still have to be approved and distributed by a state-run ministry. Furthermore, the prohibitions still apply to exports that would generate money primarily for the Cuban government, such as sugar, or that would go directly to the Cuban police, military, intelligence, or security services. Essentially, these amendments nibble around the edge of what is still a nearly comprehensive embargo of the country. **Potential Beneficiaries of the Relaxed Restrictions**
The following industries are likely to benefit from the relaxed restrictions: tourism/travel, especially the cruise ship industry, ferries, their suppliers, and health care tourism; marina operations; telecommunications; and, more generally, industries that can take advantage of the new Mariel Harbor Special Development Zone (see “Opportunities” discussion below). In the longer range, we believe the construction industry will benefit significantly as “hardscape” infrastructure needs are addressed. **Risks**
Cuba’s lack of modern infrastructure presents significant risks and limitations. *Hardscapes*. These include office buildings, roads, bridges, and utilities (water, sewer, electricity, etc.).Havana, Cuba’s capital and leading city, lacks the infrastructure to address a serious influx of demanding American tourists or to satisfy the demands of U.S.-type business operations on any meaningful scale. These infrastructure conditions are even worse outside Havana. The U.S. cruise ship industry is an exception. A cruise ship can “snuggle up” to dock, assuming the port can accommodate ships of this

size (a big assumption). A cruise ship comes with its own comfortable sleeping facilities, fresh meals, and toilet paper—none of which exist in reliable quantities in Havana, or elsewhere in Cuba. Of course the lack of hardscapes may, in the intermediate term, offer opportunities for construction-related businesses and their suppliers. *Technology.* In Cuba, despite certain exceptions—including, perhaps, in the health care industry—Internet and WiFi access is generally limited and erratic. The country has one of the lowest connectivity rates in the world; only 5 percent to 25 percent of the population has Internet service. While this could be easily overcome, the Cuban government seeks to restrain robust use of this increasingly important business tool. If Cuba's citizens and visitors do not have unencumbered access to the Internet and the opportunities associated with it, businesses will be severely limited in their ability to staff and grow. We believe the oft-suggested intention of Google to create a WiFi paradise is, at least in the near future, a "pipe dream." In this regard, the development of Chinese-style capitalism is highly unlikely in Cuba. The Chinese government is bigger, more prosperous, and better-suited culturally to play "Big Brother" when it comes to the Internet. Cuba's fading Castro regime cannot play this overseer role. Given Raul Castro's recent announcement that he will not stand for "reelection" when his term expires in February 2018, it will be interesting to see how future leaders handle the increasing demand for openness, especially from the millennial and other post-revolution generations. The telecommunications industry, though constrained by politics and hardscape limitations, is probably the most obvious possible player in the technology space. *Legal system*. Cuba's legal system is relatively underdeveloped and risky. There is no principled, robust arbiter/forum for business disputes. Cuban culture neither uses nor depends on attorneys and legal foundations as U.S. businesses do. There is no reason to expect Cuban legal institutions to be ready, willing, or able to accommodate the inevitable commercial disputes that would likely arise immediately. Uncertainty is the *single biggest risk* to the normal business operations that U.S. businesses have come to expect. Despite the well-known hospitality of the Cuban people, U.S. businesses should expect a relatively unfriendly atmosphere. Of course U.S. businesses have successfully operated in some very hostile places around the globe, principally in parts of the developing world. However, given that Cuba lies less than 100 miles from the United States, it is likely Americans will expect and demand more, in terms of good, traditional business behavior, than they do from countries halfway around the world. More objectively, given the Federal Corrupt Practices Act, Federal Tort Claims Act, and other regulatory confines, U.S. business simply cannot attempt "shortcuts" to facilitate business in Cuba. The Cuban military is directly involved in almost all aspects of the Cuban economy. As a result, we suspect Cuban government and military officials will determine who gets to do business in Cuba and what each party's "cut" will be. Many U.S. businesses have experienced this phenomenon elsewhere, *e.g.*, in China. However, we suspect that even black market systems are unrefined in Cuba, and certainly insufficient to withstand the expectations and demands of U.S. businesses. Given the relatively small market, doing business in Cuba may not be worth the hassle. Property rights, as we know them, do not exist in Cuba. Additionally, real estate ownership in Cuba is a conundrum; but, it would safe to assume you can neither own it nor obtain title insurance. Further, any business must be controlled (majority-owned) by the Cuban government or an affiliate. *Labor market*. The Cuban populace has long been suppressed. For more than 60 years,

the United States, and particularly Miami, has drained some of Cuba's "brightest and best." While there are certainly highly-educated and qualified employees and entrepreneurs in Cuba, we question whether there are sufficient Cubans with the right skill sets to begin to satisfy the personnel demands of U.S. businesses. This suspected deficiency can be addressed relatively promptly, assuming the Cuban government cooperates. Then again, no one is immigrating to Cuba any time soon. Further and more important, the Castro regime has created a dependent class and a resulting culture that views the state as the provider. **Opportunities**

The "opening" of Cuba may present several discrete areas of opportunity for U.S. business. The hospitality industry is the most obvious beneficiary. In Cuba, hotel rates are rapidly escalating—there is no "off" season. Airbnb, the website devoted to short-term home rentals, has sought to take advantage of these circumstances. However, well-known U.S. hospitality brands have made no brick-and-mortar investment, and it is not clear that European hospitality brands' efforts in Cuba have been profitable. We believe most hospitality opportunities will, for the short term, exist on the "marine fringe," which refers to cruising, marinas, fishing/diving and related eco-tourism efforts. Assuming limited government interference, which is by no means a given, these endeavors are likely to prosper immediately. Perhaps more important, there will be opportunities for *suppliers to these industries*. Remember, most who prospered during the California Gold Rush were not miners, but sellers of shovels, picks, pans, and various mining accoutrements. In connection with the "marine fringe," we recommend you review the details of the Mariel Harbor project, which is known in Spanish as the Zona Especial de Desarollo Mariel (ZEDM). This $1 billion project, designed to modernize the port and create a special economic zone, is expected to position Mariel as a major stopping point along the global maritime thoroughfare from Asia. The project is expected to be completed in 2016 and is predicted to become a major transportation/distribution hub for post-Panamax ships, especially for cargo ultimately destined for the Caribbean and northern South America. In addition to modern port facilities, ZEDM will offer foreign companies various tax incentives, including an exemption from taxes on profits for 10 years, no sales taxes for a year, and no customs duties on imported materials. Businesses will only be required to make a quarterly payment of one-half percent of gross revenue each trimester. The Mariel project has already generated a large amount of interest internationally. Brazil is footing much of the $1 billion bill to modernize the massive deep-water port that could become the largest in the Caribbean, according to a February 2015 *Los Angeles Times* article. Since ZEDM is considered more conducive to industrial projects than locations near Havana or in the Cuban countryside, international interest has been shown in developing everything from automotive and pharmaceutical factories to large-scale energy projects. In fact, more than 100 industrial projects have been proposed. Approval of foreign projects reached $200 million last year and is expected to more than double that amount for this year. Unilever is perhaps the best-known firm to receive approval to operate in the area to date. This Dutch-British consumer products manufacturer recently agreed to build a $35 million soap and toothpaste factory

in Mariel, which will be fully operational by 2018. However, several questions remain as to ZEDM:

1. Will it be a free trade zone similar to China's economic zone in Shenzhen, which was created in the 1970s and gave breaks from regulations and taxes that helped spur that country's rapid economic growth?

2. Will it be a forum (geographic niche) for full-blown, U.S.-style capitalism on the socialist island?

3. Will it have separate pro-business laws?

More details regarding ZEDM will be set forth in a future client alert. **Health Care**
Eased travel and trade restrictions will also present great opportunities for the health care tourism industry. Given Cuba's tropical climate, the island's size, its proximity to the United States, an aging U.S. population with an increasing demand for health care at reduced costs, and, most important, the availability of trained Cuban health care professionals, this industry is poised for quick growth—and is already developing much as it has in Costa Rica and elsewhere. On a related note, Cuba may become popular with retired U.S. expatriates, again like Costa Rica, along with Panama, Mexico and Ecuador. Businesses that can help Cuban entities accommodate this expected demographic wave could prosper. This includes those that already facilitate this phenomenon in other countries.
Telecommunications
The telecommunications industry also deserves another mention. With a median age of 40, Cuba's demographic skews young. This fact, plus the trend toward worldwide connectedness, presents opportunities for U.S. telecom companies. Already, the United States has implemented new rules that allow American companies to sell personal communications equipment in Cuba, work on joint ventures with Cuba's telecom monopoly ETECSA to improve the island's outdated telecommunications infrastructure, open offices in Cuba, and hire Cubans to staff them. However, Cuba has been wary of offers from U.S. companies and is proceeding cautiously in this regard. Furthermore, this space may already be sufficiently occupied by international telecom players. Still, there may be opportunities for U.S. suppliers – of telephone equipment and more. Because the telecom sector is intertwined with more widespread Internet use, it will be closely regulated by the Cuban government. **Miscellaneous**
Relations between the United States and Cuba may be thawing; however, we expect the two countries to battle over trademarks and other intellectual property rights as negotiations continue. Both sides have grievances. In the past, the United States has denied Cuban companies the same trademark protection enjoyed by brands from other countries. And, although Cuba protects trademarks registered with the government, it permits and even officially sanctions the resale of unlicensed music, software, and entertainment. A further complication is that there is generally poor knowledge of trademark/IP law among the Cuban population, a point evidenced by the fact that many Cubans name their businesses after well-known American brands (*e.g.*, "Cafeteria La McDonald's Camagueyana"). We will address intellectual property issues in more detail in a subsequent client alert. For now, it is important to know that the protection of trademarks and other intellectual property should be a significant concern for U.S. businesses investing in Cuba.

Conclusion

The "opening up" of Cuba to U.S. businesses is just the first step on a long road that will likely have many twists and turns. The forgoing represents our best guesses as to what will happen in Cuba in the business context. Some of our predictions will, no doubt, be wrong to some degree. Nevertheless, we offer these conclusions:

- With some exceptions, Cuba is a risky place for U.S.-style businesses.
- Cuba has an underdeveloped and unreliable legal system.
- There is a pending power vacuum at the top.
- There is money to be made there, but we advise you to stay close to the "miners" and minimize your in-country capital investment until there is more clarity and stability.
- Clarity and stability could be 5-10 years away.

Carlton Fields will continue to monitor developments in this area.

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