

Cuba: The Risks and Rewards for U.S. Businesses

INTERNATIONAL | BUSINESS TRANSACTIONS | APRIL 29, 2016



Dennis J. Olle

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 only the U.S. Congress can lift. Furthermore, there has been a certain, albeit restrained, reciprocity from the Cuban government.

This article explores some of the opportunities and risks associated with doing business with and in Cuba.

Facts and Recent Developments

Cuba's 2015 population was approximately 11.2 million. The country is steadily losing people due to emigration. In 2013, Cuba's estimated GDP was U.S. \$77.15 billion. Since December 2014, the Obama Administration has worked to build new relationships with the country, which was ruled by communist strongman Fidel Castro from 1959 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 shown a greater willingness to work with the United States than his brother.

The Obama Administration has loosened Cuban trade restrictions incrementally. The regulations issued by the U.S. government on January 26, 2016 amend the Cuban Assets Control Regulations and Export Administration Regulations to implement changes that include:

- Removal of financing restrictions for most kinds of authorized exports and re-exports such that U.S. financial institutions can now provide financing for the export of most products.
- Expansion of general license categories to facilitate travel to and from Cuba.
- A 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, exposing the country to more American goods, people, and ideas.
- License applications for the export of items that have been banned for decades because they might benefit the Cuban government (e.g., textbooks, sanitation equipment and construction cranes) can now be approved by the BIS on a case-by-case basis.
- Loosening of 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 between the United States and Cuba, the question remains as to how useful American businesses will find them. Exports to Cuba must still 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, 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.

Areas of Opportunity

Cuba's "opening" may present discrete areas of opportunity for U.S. business.

Hospitality

The hospitality industry is the most obvious beneficiary. In Cuba, hotel rates are rapidly escalating. 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—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.

Maríel Harbor Project

In connection with the "marine fringe," the Maríel Harbor project, known in Spanish as the Zona Especial de Desarrollo Maríel (ZEDM) will be key. This \$1 billion project, designed to modernize the port and create a special economic zone, is expected to position Maríel 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 Maríel project has already generated significant interest internationally. Brazil is footing much of the \$1 billion bill to modernize the massive deep-water port that could become the Caribbean's largest. 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 in 2016. Unilever is perhaps the best-known firm to receive approval to operate in the area. This Dutch-British consumer products manufacturer agreed to build a \$35 million soap and toothpaste factory in Maríel, 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?

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

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.

Risks of Doing Business in Cuba

Cuba's lack of modern infrastructure presents significant risks and limitations.

Hardscapes

These include office buildings, roads, bridges, and utilities (water, electricity, etc.). Havana 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 brings its own comfortable sleeping facilities, fresh meals, and toilet paper—none of which exist in reliable quantities 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 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 lack unencumbered Internet access and the opportunities associated with it, businesses will be severely limited in their ability to staff and grow.

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. 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 expect. Despite the much-touted 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 globally, 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 is safe to assume you can neither own property nor obtain title insurance.

Further, any business must be controlled (majority-owned) by the Cuban government or an affiliate.

In addition, the United States and Cuba are likely to battle over trademarks and other intellectual property rights (see "A Playing Field for Trademark Pirates" on page 12). 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, as 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.

Labor market

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 skills 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.

Conclusion

The "opening up" of Cuba to U.S. businesses is just the first step on a long road. The forgoing represents our best guesses as to what will happen in Cuba in the business context. Some of our predictions may prove more accurate than others. 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.