

# Cuban Joint Ventures and Other Forbidden Fruits

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The timing could not have been worse. At the end of 1995, a decision was made by the European law firm for which I worked to send me to Cuba to assist some clients and to investigate the possibility of establishing an office there. I arrived in March 1996, shortly after the shooting incident involving two planes flown by members of the anti-Castro organization "Brothers to the Rescue" and the adoption of the Helms Burton Act. Havana was pitch black when I arrived.

Meanwhile, my future partner, a Canadian lawyer, was working at the office of Baker & McKenzie in Budapest, Hungary on privatization and finance transactions. We met in 1998, joined forces, and established Berger, Young & Associates in order to provide investment and transaction advisory services to foreign investors and to support the development of the Cuban free-trade-zone of Mariel.

Today, the economic situation in Cuba has changed. New apartment buildings, office buildings, hotels and factories have appeared or are under construction. An increasing number of new European and Asian cars have joined the Russian Ladas and American old-timers that dominated the streets of Havana in 1996, confirming that Cuba is in business. The growth in transactions and the presence of a wide variety of foreign investors in Cuba have fundamentally changed the way that business is transacted in Cuba and have resulted in higher standards of professionalism, although the investment process at times remains difficult and time-consuming.

My partner, Cameron Young, and I intend what follows as a short overview of the foreign investment process in Cuba as it has developed over the last five years, what has happened, and what is happening.

## *Basic Framework*

In 1980, some 10 years before the collapse of the Soviet Union, Cuba adopted its first Foreign Investment Act and gradually began diversifying its trading partners and introducing the first signs of economic reform. More important reforms were made in 1995 and 1996 when a new Foreign Investment Act and an Act on Free Trade Zones and Industrial Parks were introduced. Most recently, in the second half of 2000, Cuba announced the establishment of a streamlined administrative process for foreign investments (the so-called *ventanilla única*, or single window), which is expected to diminish bureaucratic burdens and facilitate the timely execution of approved investments.

Together, these steps have resulted in the execution of a significant number of foreign investment transactions, notably in the sectors of tourism, telecommunications, electricity, mining, biotechnology, light industry, finance and tobacco. In addition, pre- and post-export finance has become available for main export commodities such as sugar,

nickel, citrus and seafood. Nonexport finance is also available, backed by offshore tourism, aviation and shipping cash flows.

In addition, free trade zones have been established to the east and to the south of Havana (in Berroa and Wajay) and in Mariel, located some 50 kilometers west of Havana. The free trade zone of Mariel in particular, which has lots of space and includes a natural harbor and an existing airstrip, has great potential to play an important role in Cuba's future economy, especially when trade with the United States is liberalized.

### *Areas for Future Growth*

The dearth of economic data and the absence of international publications dealing with Cuban economic issues have resulted in a number of important misconceptions regarding the Cuban economy. Although Cuba continues to experience difficulties in many areas, certain sectors present significant future opportunities for foreign investment.

With visitation increasing from 340,000 in 1990 to nearly 1.8 million in 2000, Cuba has been one of the fastest growing tourism destinations in the Caribbean (which in turn, is the world's fastest growing tourism areas). The various scenarios projecting the future of Cuba's tourism sector all show a consistent increase in the number of visitors over the next 10 years, particularly in the event that the US travel restrictions are lifted to allow American visitors to travel freely to Cuba. We concur in the view that there will be continued growth in the tourism sector, primarily in the construction and management of hotels and resorts, in leisure activities such as golf and boating and in secondary services such as restaurants and retail. With only one nine-hole golf course in Havana, one 18-hole course in Varadero and a handful of small marinas, it is not difficult to understand why various new courses and marinas are in the pipeline. Now that Cuba has built a visitor base with low cost, all-inclusive package tours, the time has come to diversify and build on the high end of the market.

As a consequence of the projected increase in tourism-related and other commercial activities, the need for investment and modernization of all supporting infrastructure such as electricity, water, waste treatment, telecom, roads and rail will be ongoing. In addition, we project a revival of Cuba's food, beverage and other light industries and the continued relative strength of exports such as sugar, nickel, seafood, citrus and tobacco.

For investors in Cuba's real estate sector, the freezing of joint development of apartments for sale to foreign tourists and business people has been a setback, although the joint development of office and tourism-related real estate continues.

### *Existing Legal Framework and Practice*

Under the Foreign Investment Act, investments in Cuba may be made by way of joint venture company, international economic association contract or foreign-owned Cuban company, but usually take the form of joint venture companies. The terms of Cuban joint

ventures are usually from 10 to 50 years. Investments in the free trade zones may be made by foreign companies that have no Cuban participation.

The Foreign Investment Act contains investment protection provisions. Investors are protected against expropriation unless for reasons of public utility and then are guaranteed appropriate compensation, the right to the free repatriation of profits and the proceeds of liquidation as well as the right to manage and supervise investments. Tax holidays may be granted and international arbitration procedures are now routinely agreed upon.

In general, the existing legal framework enables foreign investors to structure and manage their direct investments in a predictable and satisfactory manner. Significant room exists, however, for further improvement and clarification of applicable legislation, and the success of investments will be dependent upon the final terms and conditions agreed upon with Cuban counterparts. In addition, investors and their advisors should look beyond the Foreign Investment Act and its complementary regulations, since the Civil and Commercial Codes and various other legislative instruments will be applicable to their operations.

#### *Helms Burton Act of 1996*

The Helms-Burton Act of 1996 is the latest major component of the ongoing trade embargo with Cuba first imposed by John F. Kennedy in 1962. The extraterritorial provisions of the Act impose civil and administrative penalties and sanctions on non-U.S. investors that traffic in properties that have been confiscated from Americans. In light of the highly controversial provisions of the Helms Burton Act and the lack of an up to date public land register, title issues are particularly sensitive and difficult in Cuba. It is not uncommon for foreign investors in Cuba's real estate sector to verify, in addition to their regular title searches, whether any claim to investment properties has been included in the US Foreign Claims Settlement Commission list of certified claims and to obtain legal opinions from Cuban and US counsel in order to avoid conflicts that may arise as a result of the Act.

#### *Who are the Investors?*

In our offices hangs a painting by the Cuban artist Raúl Cordero entitled "Rule no. 1". It includes a caption which reads *No haga ruido ni preguntas* (make no noise and ask no questions), which aptly describes the view of many foreign investors in Cuba. In Cuba, no one and everyone are doing business. Canadian, European and Central and South American business people are frequent visitors. Transactions are closed and investments are made, but they are rarely announced. US investors are welcomed by Cuba but are restricted in their actions by the archaic provisions of the US embargo legislation.

Some foreign investors who have raised their heads above the horizon have been targeted under the Helms Burton Act, which appears to be based on the principle that "if we can't, you can't either", but their number is very limited. The unstated goal of the Act, to limit

foreign investment in Cuba, would therefore seem to be unfulfilled, although it is difficult to judge the chilling effect that prevents investors from making an investment in the first place. In any event, we prefer not to further identify foreign investors directly.

*Can US citizens participate?*

Embargo or no, in 1996, US cigarettes, soft drinks, foodstuffs and other products were already being sold in Cuban shops through third country distributors. Following recent changes to the embargo rules, the direct sale of food and medicine/medical equipment to Cuba will soon be possible, although it may be argued that, in the absence of US finance and with other logistics hurdles, such sales are unlikely to take place in great numbers. With important restrictions still in place, it will be challenging although well worth exploring for US traders to sell these goods to Cuba.

Direct investments in Cuba are still prohibited for US investors. That is common knowledge. However, the question of indirect investments is much less clear. On several occasions, the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) has offered the opinion: "*Persons subject to the jurisdiction of the United States may invest in a third country company that has commercial activities in Cuba, provided that (i) such investment does not result in control in fact of the third country company, and (ii) the majority of the revenues of the third country company do not result from the commercial activities in Cuba.*"

In other words, it would appear that it is possible for a US investor to hold an indirect interest in an investment in Cuba by holding shares in a non-US company that is investing in Cuba, provided that such interest is noncontrolling and that the non-US company derives the majority of its revenues from non-Cuban activities.

*Where is all this leading?*

Neither Cuba nor the United States appears likely to change its fundamental policy towards the other in the immediate future. The Bush administration will need to elaborate its Cuba policy before the present suspension of application of the right to sue provisions of the Helms Burton Act expires in July. Early indications would suggest no relaxation of the present attitude, maybe even a tightening.

In the absence of US investors, non-US companies will continue to invest in projects that would otherwise likely be developed by Americans. With the embargo still in place, it is never clear who is winning and who is losing, and all involved appear to be wishing for and preparing for a different game altogether.