

## ***Doing Business in Cuba Under the FCPA***

### ***I. Introduction***

I am back from a week of cultural and professional exchange in Cuba. It had been a lifelong dream of mine to go to Cuba and I hopped on the first trip I could enroll in after the travel for cultural exchanges were opened up last year. All I can say is if you ever get the chance to go to Cuba, especially in the next couple of years, run don't walk to sign up. It was a great experience, yet in many ways almost surreal, as if I stepped back into a 1960s movie set, complete with cars from the 1950s and buildings that have not been repaired from that time period going forward.

The International Section of the State Bar of Texas, led by Section Head George Humphrey and tour organizer, Sasha Dimitroff, sponsored trip. Our tour agent was Cuba Cultural Tours (CCT) and our CCT tour host was Dani Perez. We were hosted locally by Havana Tours, with Annia de la Nuez as our local cultural expert and tour guide. All of the people we met were enthusiastic about the changes in store for their countries. While we met with some persons who spouted the party line on history and economics, everyone recognized that change is coming to Cuba and they all wanted to be a part of it.

We met with several representatives of the government, lawyers, a historian, professors and an economist who discussed recent changes in Cuban law that have opened the country up from a pure Socialist economic system towards something like a mixed economy. I wanted to consider the impending opening of Cuba to US business, what you can do now and what you must wait for until the embargo is lifted; all from the perspective of compliance with the Foreign Corrupt Practices Act (FCPA).

The first, and foremost, thing to understand about doing business in Cuba is that the government literally owns (almost) everything. There is some private enterprise but it is very small scale, from the guys peddling bottled water on the street corner to the restaurateur who has converted his house into an eatery catering to foreigners. However these small-scale entrepreneurs must stay small scale. You can basically have a license to operate one such private enterprise. And here even the homes are owned by the government, or as it would say, the property of the Cuban people.

This means that any US business that desires to open commercial operations in Cuba will have to deal directly with the Cuban government and this clearly means the FCPA will apply to every transaction. From the moment you apply for a Visa to travel to Cuba until you walk about the departure gate at the airport to board your return flight to the US, you will be interacting with people who work for the government of Cuba. They may work for the state in a ministry, in a business that delivers products or services inside the country or interact with foreigners, such as US companies who want to do business in Cuba. But make no mistake about it, they are all paid by the government under a set pay scale across the island, with each

business delivering a product or service recognized as one provided by the government of Cuba. If those factors do not convince you, note that all such commercial businesses are owned directly by the government.

This also means that anyone (with the exception of one person I will note in a subsequent section) you hire to assist you in this process will also be a government employee under the FCPA. Every Cuban law firm, authorized to do business with foreign clients is government owned. Another chamber of commerce type person, economist or even law professor you might hire to assist you is an employee of the Cuban government so the FCPA will apply in all of your dealings with those persons and entities as well. This is true whether you consider the foreign official or instrumentality prong of the FCPA.

There are three general forms of investment that a foreign entity can make in Cuba. The first is an International Economic Association. This is akin to a partnership or teaming agreement that a foreign entity would make with an existing Cuban entity. The second is Foreign Investment Capital Enterprise, where a foreign company creates a new Cuba entity, which can be up to 100% owned by the foreign company. Such an entity cannot simply be a branch office but a separately incorporated entity in Cuba. The third is called Mixed Investment, which is more akin to a joint venture (JV). Here you should note that the best you can hope for is 51-49 split, with the Cuban government always maintaining the majority position.

The process to obtain a license to do business in Cuba is long and very drawn out. Any business looking for a quick return on investment in this country should look elsewhere as it would appear that you are looking at most probably a two-year process just to obtain a license. Clearly an investment in Cuba is a long-term play so hopefully this means companies that understand such plays will be making the entrees going forward. Also with the government interactions you will need to make throughout the process, a robust set of internal controls will be a must going forward, with your key mantra of Document, Document, and Document.

As the world has seen what happens when a socialist economy moves dramatically to a market economy, most markedly in Russia, I think it is safe to assume that the Department of Justice (DOJ) will be watching US companies very closely to monitor compliance with the FCPA. As the Russian economy may be so large and diverse, the better example of such DOJ review of conduct might be Libya, after the opening under Gadhafi. The US government encouraged several US entities to invest in Libya and now a number of those same companies are under FCPA scrutiny for their dealing with the Libyan Sovereign Wealth Fund and its employees.

While it will be easier to do business in Cuba after the embargo is lifted, which may be several years down the road, if you are interested in doing business with Cuba, you need to start preparing now rather than later.

## ***II. If Everyone is a Government Employee, How do you do Business?***

I now want work through some of the implications of this and how you might protect your company going forward.

One of the interactions we had on the trip was with four Cuban lawyers. The initial thing that was apparent was their age, from 25-30. Much, much younger than most American firms would put in front of prospective clients or even allow to represent the firm in events. They were all very knowledgeable and enthusiastic about practicing law going forward.

There are three law firms in Cuba that are authorized to do work for foreigners and are owned by the Cuban government. This has several important implications for any foreign entity doing business in Cuba. From the FCPA perspective this means all interactions will be covered by the FCPA. From the attorney/client perspective, it could also be problematic. We did pose this question to each attorney present and they all said they had never been pressured to cede any information which you and I might consider confidential to the government but as the client, you need to understand who the ultimate owner of each law firm is in all of your dealings with any Cuban lawyers.

You will need some form of counsel or advisor to navigate the Cuban laws regarding investments by foreigners. Whether you utilize Cuban lawyers or some other group or entity, such as the Chamber of Commerce, a professor with expertise in the area or another advisor, you will have the same FCPA issue. All of these persons work for entities that are owned by the Cuban government.

Typically in the life cycle of third party management, you would perform background due diligence to determine if any of the owners or beneficial owners are politically exposed persons (PEPs). However, in Cuba, any person or entity of repute that you would consider as a trusted advisor already is an employee of the government; either as a government minister or some type of advisor, such as the lawyers we met with during our trip.

On the one hand, it does make things much clearer if the government does own the entity you select as an advisor. There is no question that the FCPA is involved but more importantly, there is no question that any of the monies generated by the law firm or other entity will be going to line the pockets of a government minister who has discretionary decision making authority over your business opportunity in Cuba. The profits generated by the law firm or other entity will be paid to the Cuban government.

However, due diligence is only one step in a five-step process to manage third parties under the FCPA. The first step is still a business justification. Here it may be somewhat easier as there are so few knowledgeable counselors available to your company to consult with on business opportunities in Cuba. Once again there are only three law firms approved to do legal work in Cuba for foreign entities. Step two

in the process is the questionnaire, which is done to obtain basic information on who the owner and beneficial owner of your third party is, see if the person or entity is generally aware of the FCPA and anti-corruption compliance, see if they have received any type of training, have they been involved in any compliance related incidents and, finally, they agree to release any claims of privacy around such information requests.

While it may be apparent from the tenor of this blog post what the answers to most, if not all, of these areas of inquiry will be; I think there is an added purpose to this FCPA questionnaire. It is another step in the communication to the third party of your company's expectations around FCPA compliance and a zero tolerance for bribery and corruption. Moreover, given the level of sophistication by Cubans around international anti-corruption legislation, the questionnaire process will most probably require detailed and lengthy explanations but you will have the opportunity for some serious education in not only what the FCPA requires but your company's expectations.

The next iteration in the five-step process is the contract. The FCPA Guidance specifies some minimum compliance terms and conditions which should be included in any contract with a third party consultant. These compliance terms and conditions include audit rights; training requirements around the FCPA and other anti-corruption laws; representations that the consultant will abide by the FCPA and other anti-corruption laws; and ensuring that payments requested by consultant have the proper supporting documentation before they are approved for payment. I would also add that you should include language which makes a FCPA incident a material breach of contract; full cooperation by the consultant with any FCPA investigation and possibly an indemnity for FCPA violation.

All of these compliance terms and conditions are going to be new to any consultant you retain in Cuba, law firm or other. You will need to explain why they are required and how they may be invoked. Many persons and entities outside the US, when they are first confronted with these compliance contract requirements, are insulted, mistakenly thinking you are saying they will engage in bribery and corruption. This can be a delicate educational process but one which you will have to patiently explain.

All of this leads to the final step in the five-step process but one that I have come to believe may well be the most important step; managing the relationship after the contract is signed. I think it is self-evident that you will need to put on your own FCPA compliance training, as there will be no local assets of experts you can retain. While all of the lawyers we met with spoke very good English, my suggestion would be to put on the training in Spanish for more complete understanding by the participants. This means a translator or Spanish speaking FCPA expert will be needed.

Finally, you need to consider the payment terms. The FCPA Guidance says that you should look at “how those payment terms compare to typical terms in that industry and country, as well as the timing of the third party’s introduction to the business.” The FCPA Guidance also specifies, “Moreover, companies may want to confirm and document that the third party is actually performing the work for which it is being paid and that its compensation is commensurate with the work being provided.” This may be hard because there is no historical data for you to compare other than the standard hourly rates charged by the three Cuban law firms for general corporate work.

The FCPA Guidance makes clear that compensating a third party for commercial services rendered is acceptable and well within the parameters of the FCPA. What companies will have to do is to document all of the steps I have laid out. The Fox Mantra of Document, Document, and Document will play out as strongly for any company doing business as anywhere in the world; perhaps even more so. Due to the very unique nature of the Cuban economy the pressure maybe greater for step five, aka managing the relationship after the contract is signed. Finally, you will have to communicate and educate your Cuban business partners on your obligations under the FCPA and the obligations they will find themselves under when they do business with an American or other foreign company subject to the FCPA.

### ***III. A Canadian Lawyer in Cuba***

Earlier I referred to the one person I am aware of you might consult for advice in Cuba, who is not a Cuban government official. That person is Gregory Biniowsky, who is a Canadian by birth but has lived in Cuba for nearly 20 years. He is a Consultant with Gowlings Consulting Inc.

On the firm’s [website](#), Biniowsky is listed as a “Havana-based business consultant for Gowling WLG. He has experience in providing strategic advice to companies assessing potential ventures in Cuba, assisting clients in navigating the complexities of the Cuban legal, political and economic systems, and has assisted in the negotiation of investment projects in Cuba on behalf of foreign investors. Gregory’s professional work in Cuba has also included working as a consultant for Canadian and European business ventures, a consultant for the United Nations development program in Cuba, a consultant overseeing development funds of the Canadian International Development Agency, and as a locally based consultant for the Canadian Embassy in Havana.”

Biniowsky is also the founding partner of Havanada Consulting Inc. which is a consulting firm specializing in giving advice to philanthropists, charitable foundations and developmental NGOs who desire to undertake or fund non-profit projects in Cuba. I should also note that he is also the founder of the restaurant Nazdarovie, which is a Cuban-Soviet inspired eatery with a homage to all things Soviet and those Soviets who settled in Cuba during the country’s close relationship with the former Soviet Union.

As Biniowsky is a private Canadian citizen, business interactions with him directly do not implicate the FCPA. This does not mean that if you hire him as your business consultant to advise you on the steps to do business in Cuba, the FCPA will not apply to his interactions with Cuban government officials. He will be like any other agent you might retain in any other country who will interact with the government on your behalf.

Biniowsky spoke to our state bar group. One of the things he emphasized was that corruption is not a problem in Cuba. He believed that Cuba scored well in the [Transparency International - Corruption Perceptions Index](#) (TI-CPI). However when I reviewed the TI-CPI I found that Cuba ranks 56 out of 168 countries on the scale, coming with a score of 47 out of 100. It is ranked just below Kuwait and just above Greece. Not exactly a singing recommendation.

Although it is not clear precisely what led to such a low score, the country was given low marks for freedom of the press, the rule of law, human development and voice and accountability. That sounds like they were penalized for being a closed, communist country without much consideration about actual bribery and corruption. However, as Biniowsky correctly noted, it has the third best score in Central and South America, which says something on its own about the perception of corruption in the entire region.

He also had some interesting insights in what the Cuban government may be looking for from an investment partner or other foreign company coming to Cuba. First and foremost, it is not simply the economic priority driving the government. The government is seeking to grant licenses to companies which will further its political and social priorities. For instance, the country is not able to feed itself and must import foodstuffs. With a national population of 11.2 million, a current annual tourist number at 3.5 million and the government looking to increase this amount to bring in hard currency, you can quickly see that increasing food production is a top priority.

Understanding these underlying issues, usually guided by a local expert, such as Biniowsky, is critical to beginning to grasp the issues you will face in doing business in Cuba. Your counter-party in all negotiations, some department or ministry of the Cuban government may not respond to what you believe are clear economic arguments.

Another key aspect is trust. This is something different from the Chinese concept of *Guanxi* or the system of social networks and influential relationships that facilitate business dealings in China. It comes from what might be termed as a society that has been under one party rule for most of the collective memory of island residents. It is even more than your word is your bond. It is your word and your actions are your bond. It is not your contract rights but what you said you would do and then actually did going forward.

Finally, you will need to understand the Cubans are a fiercely nationalistic people. Insulting them as little brothers and sisters or anything similar is about the quickest way to be shown the door. Lording some US laws, technology or cultural aphorism over them will simply not work. This does not mean you go hat in hand but with a large modicum of respect.

It does take patience and time to do business in Cuba. The Cuban government will be the most active business partner for the foreseeable future in almost all endeavors so there will be full FCPA scrutiny at all times. Nonetheless simply because the government will be so intimately involved in all business activity does not mean there will always be bureaucratic dogmatism at every turn.

Biniowsky emphasized there may be many things possible that you might not have considered. He provided an example that he was involved in for a US client. Recognizing there is still a commercial embargo, the client proposed meeting with the appropriate government representative to negotiate on a 'what if' the embargo is lifted basis. This permitted more than simply sitting across the table sizing up your potential business partner, as it allowed the parties to discuss into the weeds on many aspects of a proposed business relationship going forward.

Biniowsky ended his remarks by laying out three strategies that US companies might employ at this point. The first is to simply wait out the lifting of the embargo, however many years down the road this might be. The second is to invoke something called the 49-49 rule, which generally speaking says that a 49% investment in a company that is 49% foreign owned in Cuba could possibly meet the current embargo standard. Finally, there is something called the [Herzfeld Caribbean Basin Fund, Inc.](#) which invests primarily in equity securities of public and private companies, including US-based companies, which it believes will "benefit from economic, political, structural & technological developments in countries within the Caribbean Basin, including Cuba."

Doing business in Cuba can be very challenging. You will certainly need competent US counsel to advise you on trade sanctions as well as good FCPA counsel and Cuban advisors as both counselors and business advisors. And you will need all of this before you start talking to the Cuban government.

#### ***IV. Corporate Structures***

Next we consider the types of ownership structures that are currently in place and the FCPA issues deriving therefrom. At this time there are three recognized forms of investment: (1) Joint Ventures (JVs); (2) Foreign Capital Company; and (3) International Association Agreement.

##### ***Joint Ventures***

The first thing to note about JVs in Cuba is that the best you can get is 49% ownership, with the government controlling the remaining 51%. In Cuba, a JV is a separate legal entity that is registered with the government. It is a different legal entity from the two partners and issues shares to its partners. To create a JV you will be required to obtain the authorization of the competent government ministry or state body. The legal documents required are an Association Agreement and Articles of Incorporation.

### ***Foreign Capital Company***

This is a separate Cuban domiciled and created corporation, which once again must receive a state license to be created. It must be legally created in Cuba and cannot simply be a branch of an existing foreign corporation. It must issue registry shares to create a legal person who can do business in Cuba. Standard corporate governance documents must be created but this allows the full range of business activities to be conducted both in Cuba and abroad by the Cuban Corporation.

### ***International Association Agreement***

This form of entity is more akin to a teaming agreement or some other form of dual participation that is something less than a JV. A foreign company or person might contribute some monies on a project or other basis where they could accrue shares but it is not a capital share. It does not involve the creation of a new corporate entity but is validated by the filing of a public deed and is entered into the Business Register.

Of course, you will have to open a bank account in Cuba. The Central Bank of Cuba heads the Cuban banking system and it consists of nine commercial banks, 15 non-banking institutions and 10 representative offices of foreign banks in the country. Foreign entities are entitled to have accounts and indeed once an investment is approved, the foreign entity is required to open a demand deposit account to receive funds that might come into the company.

I have gone through a somewhat detailed explanation of corporate and business venture structures to re-emphasize the key theme of this week's blog post. At all times, for all business relations in Cuba, you need to assume you are dealing with government officials. This is true whether they work for a ministry issuing a license to do business in Cuba, a government enterprise doing business in the country or even at a bank. They are all going to be covered by the FCPA.

But more than just understanding what all of your interactions will be with government officials, you should think about the types of corporate structures you want to put in place to protect yourself. As is stated in the FCPA Guidance, "Although the FCPA's accounting requirements are directed at "issuers," an issuer's books and records include those of its consolidated subsidiaries and affiliates. An issuer's responsibility thus extends to ensuring that subsidiaries or affiliates under its



control, including foreign subsidiaries and joint venture partners, comply with the accounting provisions.” This means a US company is responsible for the actions of its JV partners. If you only have a 49% interest, you may not be in a position to control the JV governance or actions.

Similarly, under the International Association Agreement you will have very little ability to control the actions of the entity you are contributing into. This means that in both the JV and this structure, a lengthy and intense dialogue will need to ensue over your expectations not simply that there is no place for bribery and corruption but there will be affirmative compliance with the FCPA. You will also need to put on FCPA training for the JV leadership or your investment partner. Finally, while ongoing monitoring may seem problematic, it will be necessary. You will need to have a formal FCPA compliance program, consisting of policies and procedures in place for a JV or foreign capital company.

The key is going to be your documentation. As every interaction will involve a foreign official under the FCPA, every time you entertain, treat to dinner or meet with a foreign official there should be a record. Before your business folks exclaim, “What an order, I can’t go through with it”; remind them that documentation is a good business practice and indeed will facilitate the business sales process. Moreover any expenses incurred should be recorded for tax reporting purposes.

At some point you will also most probably face the issue of travel by Cuban officials to view your products or sites in the US or other countries. The travel issues seems to bedevil US companies to this day regarding travel of Chinese officials to the US. Yet, to comply with the FCPA, travel for foreign officials is a straightforward exercise with guidelines that have been in place for several years so it really should not be that difficult to comply with the FCPA in the area of bringing Cuban government officials to the US or other locations outside of Cuba. Indeed there have been two Department of Justice (DOJ) Opinion Releases, 07-01 and 07-02, which lay out the requirements that will help to keep you out of FCPA hot water in this area.

Finally, and most importantly, is the Compliance Evangelist mantra, “Document, Document, and Document”. Whatever your engagement is with Cuban officials commit it to paper. If it is travel, gifts or entertainment, catalogue every expense so you can show to any regulator who comes knocking that you are in compliance with the FCPA. The reason is simple, if you do not have appropriate documentation, a regulator reviewing you may well conclude there is a FCPA violation, with no demonstrative evidence to the contrary.

## ***V. Final Thoughts***

It appears to me that the two biggest issues are from the American side, reparations to be paid to person and companies whose land and properties were confiscated. From the Cuban side, the biggest issue is the US trade embargo. There are other issues that I heard discussed during my weeklong visit and they include

Guantanamo, the Cuban Adjustment Act and subversion. I am sure there are others but even with this list you can see the difficult negotiations ahead for both sides. Couple these issues with an American political system which is in or near complete dysfunction and the continued rule of the Castro brothers, formerly Fidel and now Raul, and it is clear that the path will be challenging.

Additionally as I have tried to make clear, everyone you deal with is a government employee in Cuba. This means that the plumber you hire to help renovate or fix your buildings pipe systems is a government employee. The same is true for the air conditioning repairman, the telephone technician, electrical repairman and all other similarly situated workers. They are all paid a set wage by the state; something like 300, 500 or 800 pesos per month. This leads to everyone trying to do anything to supplement their income.

Now consider what will happen when you need their services. Under the FCPA, a Facilitation Payment might be considered to move yourself or your company up the list to obtain repairs or work earlier. Now consider the amount of this Facilitation Payment. What might be appropriate: 20, 50 or 100 pesos? Even at a one-to-one exchange rate, these amounts would all probably pass muster under a FCPA analysis, if they were properly recorded in your books and records as Facilitation Payments.

But what if the US government looked at it in a different manner? Such as considering the amount of the Facilitation Payment as a part of a monthly income? Now how does 50 pesos look to someone whose monthly pay is 500 pesos? Does a Facilitation Payment become a bribe when it is 10% of the monthly income of the person receiving the payment? How about on an annual basis, does a Facilitation Payment of 1% of the receiver's annual salary constitute a bribe? The best I can say at this point is there are no FCPA enforcement actions where this issue has arisen. This would lead to *speculation* that such an amount is a Facilitation Payment so it is exempt from FCPA enforcement but I can certainly see an argument going the other way.

How about the hiring of Cuban government official when they leave the employ of the government? The government has announced it plans to reduce the size of its bureaucracy by over 10% by the creation of jobs in the soon to arise private sector. This could well lead to a very fast moving one way (not revolving) door from government regulator to private sector employees in the same industry or business segment. On the one hand it makes perfect business sense to hire someone from the Ministry of Agriculture, if your US based company is entering into the Cuban agricultural market because of their technical expertise or knowledge. On the other hand, it may certainly appear as if a promise might have been made that if my company's license is approved, that some government official who had decision-making authority or even influence received something in return for discretionary decision.

If the latter were true how long should there be between receipt of license and hiring away of the government official? Should there be window for non-poaching? Yet, where else are you going to find a talent pool specific to a Cuba business segment? How about local content requirements? All potentially difficult questions where the answer might appear quite reasonable under one analysis. Yet a few years later, under a different review it may appear to raise a FCPA issue. You only need consider the investment banks under scrutiny for conduct in Libya for their interactions around that country's sovereign wealth fund to see the potential danger.

Finally, with all of the potential issues I have laid out in this series, simply under a FCPA analysis, why would your company even go into Cuba? You need to consider not only the FCPA but a whole host of topics I have not touched upon, such as the legal system, rule of law, independence of judiciary, monetary and export controls and a whole host of others; all the while trying to make a profit. This is not China with a potential market of billions but an island nation of 11.2m people.

Yet even with all these considerations, I believe you should contemplate going into Cuba for several reasons. It is only 90 miles south of the United States and sits at the very crossroads of the intersection between North American, Central America and South America. It is by far the largest island in the Caribbean and has the potential to be one of the leaders in the Caribbean basin. The potential market is still available to your company and has a population with literacy approaching 99% so it presents a workforce with an education level far above any other country in the region. Lastly, how many times in your lifetime or your company's existence do you have the chance to enter into a truly new market?