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Client Alert

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Thawing of US-Cuba Relations and Changes in Cuban Laws Attract Foreign Investment

On January 12, 2016, it was announced that British-Dutch multinational consumer goods company Unilever plc ("Unilever") will be returning to Cuba. According to current reports, Unilever entered into a joint venture with Cuban state firm Intersuchel to create Unilever-Suchel SA. Unilever will reportedly build a $35 million soap and toothpaste factory in the Mariel Special Development Zone (the "Zone") and begin operations in Cuba in 2017, making it the ninth firm to receive approval to operate at the Zone.

This is not Unilever's first venture in Cuba. In 1994, Unilever formed a 50/50 international economic association with Suchel. Unilever's operations in Cuba were not without challenges, however. First, labor productivity appears to have been below levels registered elsewhere in Latin America and the Caribbean. Second, the Cuban labor regulations made it very difficult to fire workers and labor unions tended to protect delinquent employees. There was also substantial government intrusion into Unilever's supply chain, including the government's expressed preference for local suppliers and fixing of prices for inputs and outputs. Unilever left the Cuban market in 2012.

More recently, Cleber LLC, an Alabama based company established in 2015 ("Cleber"), received approval from the Department of Commerce and the Treasury Department in early February to build a tractor factory in Cuba and is now in the process of finalizing negotiations with the Cuban regulators. If the factory is completed, it would be the first major business investment by a US company in Cuba since 1959. The factory, which has an estimated cost of between $5 million and $10 million, is expected to be built in the Zone by the end of 2016 to start production of small tractors in 2017.

Normalization of US-Cuba Relations

Unilever's decision to return to Cuba may be motivated by the recent thawing of relations between the US and Cuba. On December 17, 2014, President Obama announced a policy to increase contact and engagement with the people of Cuba with an ultimate goal of normalizing relations between the US and Cuba. On the US side, this policy change has resulted in various changes to the Department of Commerce's Bureau of Industry and Security's (BIS) Export Administration Regulations (EAR) and the Department of the Treasury's Office of Foreign Assets Control's (OFAC) Cuban Assets Control Regulations (CACR), the two primary sets of regulations that govern the provisions of the Cuban embargo. The US has also removed Cuba from the list of State Sponsors of Terrorism and the two countries have reopened their respective embassies, thereby formally re-establishing diplomatic relations. These changes have allowed and encouraged US companies like Cleber to engage in business with Cuba.

More recently, OFAC and BIS updated the CACR and the EAR on January 26, 2016. The amendments permit US companies, which could previously only attend professional meeting or conferences in Cuba, to also organize such meetings. Furthermore, BIS has changed its policy of approval for certain items so that the exportation of items that strengthen civil society in Cuba, telecommunications items, items that promote civil aviation safety and items that meet the needs of the Cuban people will now be generally approved. Finally, the recent amendments remove financing restrictions for most types of authorized exports and authorize US depository institutions to provide financing, including, for example, issuing a letter of credit for authorized exports and reexports. The changes to the regulations also permit exporters to sell to Cuban counterparties on an open account. Although these amendments postdate Unilever's decision to return to Cuba, they evidence the continued process of normalization of relations between Cuba and the US and suggest that foreign businesses may be seeking to enter the Cuban market before restrictions continue to be removed and they face competition from US companies such as Cleber.

Additionally, there are various bills pending in both houses of Congress that seek to further reduce the restrictions imposed by the Cuban embargo or repeal the embargo altogether. For example, the Free Trade With Cuba Act (H.R. 403), the Cuba Reconciliation Act (H.R. 735) and the Cuba Trade Act of 2015 (S. 1543) are three presently pending bills that seek to lift the restrictions imposed by the embargo. On the other hand, bills like the Cuba Human Rights Act of 2015 (H.R. 1782) and the Cuba Normalization Accountability Act of 2015 (H.R. 2466) seek to make any further removal of restrictions or repeal of the embargo altogether conditioned upon Cuba meeting milestones in relation to human rights and the repayment of outstanding claims owned by US persons, respectively.

Changes in Cuban Laws and the Creation of the Mariel Special Development Zone

Concurrently with the thawing of US-Cuba relations and all of the changes undertaken by the US set forth above, Cuba has implemented changes to its own laws and regulations in an attempt to make itself more attractive to foreign investors.

Law 313 and ancillary regulations, in effect since November 1, 2013, created the Zone, the site for Unilever's and Cleber's presently proposed factories. The Zone features a 0% profit tax during 10 years and extensions may be granted by government exemption. Following the initial 10 year period, profits are taxed at 12% while reinvested profits are not taxed at all. Labor taxes and contributions to local development are also exempted in the Zone. Taxes on sales or services are exempted during the first year of operations and are 1% after the first year.

In early 2014, the Cuban government also passed a new foreign investment law. Law 118, the "Law of Foreign Investment" offers deep tax cuts and provides investment security to investors. For investments not taking place in the Zone, Law 118 provides a 0% profit tax during the initial 8 years of operations in Cuba. After the initial 8 years, investors pay a 15% profit tax, which is subject to increase by an additional 50% for exploitation of natural resources. Law 118 also seeks to reduce labor costs and provide protection from expropriation.

On June 17, 2014, the Cuban government promulgated Law 116, Cuba's new labor code. The new labor code, intended to recover labor discipline and strengthen trade unions' role in ensuring efficient production, allows employers to, among other things, undertake various disciplinary actions for violations of work discipline, such as fines of up to 25% of the worker's base salary which may be garnished in amounts of up to 10% of the worker's base salary each month. Thus, this law is intended to address some of the issues that Unilever encountered in Cuba in its prior venture in the island and thereby attract foreign investment.

In addition to the foregoing, Cuba has also begun to evaluate a path to unify its currencies. Cuba currently has two currencies, the Cuban peso ("CUP") and the Cuban convertible peso ("CUC"). The CUP circulates largely in the domestic economy while the CUC is used primarily by foreign investors and in tourism. Unification of the currencies, the date of which remains uncertain, would allow foreign companies to participate in the domestic Cuban economy, which has been nearly exclusively reserved for Cuban state-owned entities. With currency unification, Unilever, Cleber and similar foreign investors would be able to compete head-to-head with Cuban state-owned enterprises in a single national market.

Conclusion

Recent changes to Cuban laws and regulations governing the foreign investment, currency, taxation and labor systems, in conjunction with the normalization of US-Cuba relations, have generated interest for foreign investment in Cuba from not only US companies, but also foreign businesses seeking a first mover advantage over US companies that may become future investors. The result of the recent changes is to create a more investment-friendly environment in Cuba that has attracted companies like Unilever, which had left the Cuban market, and newcomers like Cleber. Others have moved their existing Cuban operations from other parts of the island into the more tax-favorable Zone.

The Latin America Group at Hunton & Williams LLP will continue to closely monitor related developments. Please contact us if you have any questions or would like further information regarding the normalization of US-Cuba relations or any regulation or sanction governing the Cuban embargo.

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