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The Cuba Embargo: What Now?

THE PAUL HASTINGS GLOBAL TRADE CONTROLS GROUP

Sixteen years ago, we led a group of American business executives on a one-day exploratory mission to Havana.

That mission was legal—only because of a gap in the U.S. regulations by which all dealings with Cuba by U.S. nationals were embargoed: Treasury's embargo rules proscribed all transactions with any Cuban national anywhere in world, but if an American travelled to Cuba and didn't spend a dime (or peso), she was in full compliance with the Cuban sanctions. Our 50-member group, "fully hosted" by the Cuban authorities, was not required to pay for anything once we arrived for the flight from Cancun to Havana. We met with a variety of ministry officials, endured a lengthy tirade against the American embargo by then-head of the National Assembly Ricardo Alarcon, topped the day off with cocktails with an aging (but, at that time, still sharp) Fidel Castro, and flew back to Cancun late that night. We paid for nothing.

Treasury promptly closed down the "fully hosted" loophole, so that no similar trip would occur again.

If anyone began that trip with a clouded view of whether the U.S. embargo on Cuba (then in its 37th year) was useful, the visit extinguished the doubt. Cuba clearly had been decimated by decades of Castro rule and Soviet financial crutches, but the notion that the embargo contributed anything to the restoration of a democratic movement or the weakening of the regime was plainly wishful thinking.

This week President Obama declared the embargo—soon to enter its 54th year—a "failed approach": in the White House's words, "[d]ecades of U.S. isolation of Cuba have failed to accomplish our objective of empowering Cubans to build an open and democratic country." The President accompanied that declaration with a handful of immediate actions that fall within his executive and foreign affairs authority, beginning with opening of discussions to reestablish diplomatic relations between the two countries and to reopen an embassy in Havana "in the next coming months."

What exactly does this mean for American businesses? For non-U.S. companies in Canada, Mexico, or Europe who have sought our assistance in avoiding complications with U.S. enforcers in carrying out their business relationships in Cuba?

Limited New Avenues; No Congressional Action Required

The most prominent feature of the Administration's new Cuba policy is what it does not say: the steps the White House can take are highly constrained under the law, which since the 1990s has enshrined the Cuba embargo regulations with statutory force.

In other sanctions regimes over the years—Libya, Iran, Iraq (under Saddam), Sudan, Panama (under Noriega), etc.—the President has been free to adjust the scope of restrictions at the edges as a lever to encourage favorable behavior by the targeted country. Congress sought to remove that power with respect to Cuba in the 1996 Helms-Burton Act. Since that time, it has been part of received wisdom that the President and the Treasury Department cannot make substantial changes in the Cuba restrictions by regulatory action alone.

The Obama announcement this week appears to toe this line, referring carefully to actions the Administration will take that are “authorized by [current] law.” The White House statement does not indicate that it will seek any modification of existing legislation from Congress. This is hardly a surprise with both houses of Congress falling under firm Republican control as of January. But as a consequence, the measures the White House has promised are modest in scope:

- *Travel.* The restrictions on U.S. persons will be tweaked at the margins in “the 12 existing categories of travel to Cuba authorized by law.” The current general licenses—which permit travel without any prior approval by Treasury—will remain in place for journalists, researchers, religious and educational trips, and medical and agricultural businesses, but new general licenses will be established for athletic competitions, artistic performances, “private foundations and institutes,” and “support for the Cuban people, including human rights work.”
- *U.S. debit and credit cards.* Use of U.S.-issued credit cards will be permitted for travel to and in Cuba, which will substantially ease the mechanics for Americans engaged in business or pleasure travel.
- *Banking relationships.* U.S. financial institutions will be permitted to establish accounts with Cuban banks in order to process transactions.
- *Exports of hard goods.* American manufacturers will be allowed to export products to private sector entrepreneurs in Cuba, and U.S.-origin building materials will be exportable for private sector residential construction.
- *Internet and cellphones.* Exports of telecomm equipment will be liberalized.
 - Here the White House “fact sheet” oddly resorts to the passive voice to report that “[t]he commercial export of certain items that will contribute to the ability of the Cuban people to communicate with people in the United States and the rest of the world will be authorized,” including “the commercial sale of certain consumer communications devices, related software, applications, hardware, and services, and items for the establishment and update of communications-related systems,” and that “[t]elecommunications providers will be allowed to establish the necessary mechanisms, including infrastructure, in Cuba to provide commercial telecommunications and internet services” Producers of cellphones and telecomm equipment in, for example, China and Finland have long been free to supply Cuba, and yet (as the fact sheet reports) internet penetration in Cuba is less than 5%, and costs for cellphones and cell service are prohibitively high. It is unclear whether this passive language marks a White House *sotto voce* announcement that the Castro regime has agreed to liberalize internal rules on telecomm and internet as part of the new deal with

the U.S., or whether it merely indicates that American companies will now have an opportunity to seek to play in the very limited Cuban consumer telecomm market.

These steps are far more modest than the rhetoric that accompanied the announcement, or first-day hype in the U.S. media. They certainly do not amount to a reversal of the embargo. Clients who see opportunities in Cuba have little choice but to adopt a wait-and-see approach until Treasury's Office of Foreign Assets Control (OFAC) issues changes to the Cuban trade controls, and until the Commerce Department's Bureau of Industry and Security (BIS) provides guidance on what technology exports will now be permitted. OFAC staff is accustomed to working furiously through holidays and weekends to bring its sanctions rules into conformity with announcements by policymakers, and they surely will be doing so this holiday season as the single largest change in American sanctions policy in decades unfolds.

New Space for U.S. Overseas Subsidiaries?

In one area, however, the new Obama Cuba policy may prove more than a modest change. Perhaps the most intriguing morsel in the White House's Cuba "fact sheet" is this sentence: "U.S.-owned or -controlled entities in third countries will be generally licensed to provide services to, and engage in financial transactions with, Cuban individuals in third countries."

If this sentence means what it says, the change will be noticed and welcomed by European and other trading partners who have long criticized the long reach of the U.S. Cuba sanctions to activity carried out by non-U.S. companies and employees outside the U.S. A prime example is recent: the April 2014 settlement with OFAC entered into by the well-known travel provider Carlson Wagonlit Travel. Carlson, a Dutch company, had handled travel by Europeans to Cuba for decades. But as of 2006, the majority of its shares became held by Americans. That made it subject to OFAC's Cuba rules. Carlson self-reported to OFAC that its non-U.S. units had handled travel for more than 44,000 people to or from Cuba over a several-year period. As a consequence, OFAC extracted a \$5.99 million settlement from Carlson.

As described by the White House, the new Cuba policy would apparently treat Carlson's non-U.S. subsidiaries in non-U.S. locations as licensed to provide Cuba travel services to "Cuban individuals" outside the U.S. or Cuba. But how about, for example, a Dutch traveler who asks Carlson's Amsterdam office to book him to Havana? While that person would not be a "Cuban individual" with whom Carlson would be licensed to deal, is there a justification for continuing to treat that transaction as proscribed by OFAC's Cuba regulations, yet allowing it for a Cuban national making the same booking in Amsterdam?

On this issue, U.S. allies unsupportive of the historic Cuba policy—which is virtually every major ally the U.S. has—can be expected to press the Obama Administration to extend the relaxation at least to non-U.S. offices doing business outside the U.S. with non-U.S. citizens, regardless of U.S. ownership up the corporate chain.

The Obama Administration is likely to claim its hands are tied on this point by Congress. Among the provisions of the 1996 Helms-Burton Act is language declaring that "[t]he economic embargo of Cuba, as in effect on March 1, 1996, including all restrictions under part 515 of title 31, Code of Federal Regulations, shall ... remain in effect" unless and until the President certifies that a "transition government" has assumed power in Havana. The President can make such a finding only if at least 8 specified factors are present. Among those factors are that the government "does not include Fidel

Castro or Raul Castro,” that it has “legalized all political activity” and “released all political prisoners,” that it has committed to a timetable for “free and fair elections” with “multiple independent political parties” and “UN or equivalent election monitors,” and that it is establishing an independent judiciary. No such finding is plausible at present, of course. Since “all restrictions” under the OFAC Cuba regulations must remain in place by statute until such a finding—including the restriction on activity of foreign subsidiaries owned or controlled by U.S. persons—there is no basis for optimism that American companies (or European companies owned by Americans such as Carlson Wagonlit) will see relaxed rules anytime soon.

Two Mysteries

The Cuban reaction. Cuba watchers have long thought that the Cuban governmental reaction to the change in U.S. policy—whenever it came—would be positive. In part that expectation turned on the presumption that no U.S. administration would make the move without substantial commitments from Cuba that promised that the change would be welcomed. In part it was due to the new generation of officials that is nudging the Castro-era octogenarians off the stage, and that has grown up in the post-Soviet, post-ideological era in which Cuba’s former allies in the Soviet bloc largely transitioned to modern, economically expanding, and sometimes democratic societies. Simply put, the people who will be running Cuba once the Castro brothers are gone—with or without a change toward democracy and a non-state-controlled economy—see the anachronism that Cuba has become, and will be moving away from it, whether overtly or covertly.

Havana has not disappointed this expectation. The Obama announcement was coordinated with a similar, unexpected appearance by Raul Castro confirming the contacts between the two leaders. We are advised by persons involved with the year-long negotiations that this week’s announcement is likely to be followed by other business and governmental events in the coming weeks that are aimed at locking in the policy changes against the hardliners in political circles in both countries.

The Congressional response. The largest wildcard is what the new Republican Congress will attempt to do on Cuba policy. In recent decades, Republicans have led the hardline opposition to any relaxation of the embargo. Today’s Republican Party still contains sizeable elements that take the Jesse Helms-Dan Burton approach to any dealings with Cuba as long as the Castro coterie remains in control. Florida senator Marco Rubio’s reaction to the Obama announcement, predictably, was scathingly hostile (“another concession to tyranny”). Former Florida governor Jeb Bush similarly staked out an adversarial posture, accusing the Obama White House of “reward[ing] ... dictators.” Other aspiring Republican presidential candidates who have kept quiet on the Cuba embargo can now be expected to line up in opposition, in order to keep their prospects in a 2016 Florida primary intact.

A noisy round of congressional hearings is a certainty for the new Congress, but whether the noise will produce legislation to block the Obama initiative—even with Republican majorities—is by no means a foregone conclusion. Nor would the shape of a veto-override vote be easy to project; the new Obama policy will draw support from some traditional Republicans, but a pocket of anti-Castro Democrats (such as New Jersey senator Bob Menendez) will not vote with the President on Cuba legislation.

Thus, the decibel level will surely escalate as a result of the White House action—but what will emerge will depend on several factors: whether concrete steps follow this week’s announcements in Washington and Havana; whether the U.S. Chamber of Commerce and its business allies can generate positive support in conservative circles to offset the amped-up anti-Obama attacks on the new policy; and whether the Obama initiative has demonstrable impact among the bloc that is increasingly critical

in national elections—Latino voters who may see the opposition as tinged with anti-Latino color, or who may (outside the Florida Cuban émigré population, which is itself split on the issue) see the Cuba embargo as unrelated to the immigration policy on which their concerns focus.

The Enforcement Question and Voluntary Disclosures

One key unspoken question is whether the new Obama policy will extend to enforcement action by OFAC and federal prosecutors. Notwithstanding the lack of enthusiasm for the Cuba embargo that has characterized the last two Democratic administrations, enforcement actions have hardly waned during the Obama years. For example:

- The Carlson Wagonlit settlement in April 2014 resulted in a penalty that exceeded \$5.9 million.
- In May 2014, AIG settled an OFAC charge that three non-U.S. subsidiaries had engaged in dealings with Cuba, by agreeing to pay a \$300,000 penalty.
- Similar enforcement actions on Cuban dealings within the past two years have involved Royal Bank of Scotland, Bank of Tokyo-Mitsubishi UFJ, HSBC Standard Chartered Bank, and ING.

The White House “fact sheet” contains the obligatory language that “[p]ersons must comply with all provisions of the revised regulations; violations of the terms and conditions are enforceable under U.S. law.” How forcefully Treasury and OFAC will back that up with new enforcement actions, in a climate in which the White House is trying to leave the old Cuba policy behind, will be interesting to watch.

One immediate consequence may be to change the calculus on voluntary disclosure of Cuba violations. OFAC’s stated policy is to provide leniency to violators who voluntarily disclose their infractions to OFAC prior to any investigation starting. (The size of some voluntary-disclosure-generated settlements has left some practitioners wondering how wise it is to advise clients to fess up to OFAC rather than to take their chances on the violations not being discovered.) The new Cuba policy may cut both ways: a company that knows it has violated antiquated rules that U.S. policy now declared to have been a failure might find it easier to make a voluntary disclosure (on the assumption that OFAC will not see a need to extract a large penalty), but it might also find it less risky to bury the violations in the hope that OFAC will not learn of them or, if it does, will not want to dedicate its resources to a lengthy investigation when other targets—Iran, Sudan, the Putin regime—are at the center of its enforcement attention.

For Non-U.S. Businesses

For a number of our clients—from Canada and Mexico, to Spain, and to Japan and Korea—compliance with OFAC’s Cuba regulations has been a headache. Will that stop?

Unfortunately, no. The Cuba embargo rules apply to all U.S. nationals—wherever located, and by whomever employed. A Canadian company can run afoul of OFAC’s rules by employing an American who participates—whether as a salesman or a member of the board of directors—in dealings with Cuba. Walling off American executives or employees from business activity with Cuba will continue to be required, except in the categories of business that are subject to the general license. Thus, a Chinese company that hires an American to lead its North American business strategy will continue to have to carve him out of any dealings with Cuban customers. A European hotel operator who acquires

management contracts on several Caribbean properties will not be able to use American personnel to oversee the affairs of a Cuban resort.

In addition, as already noted, non-U.S. subsidiaries of U.S. entities will remain unavoidably subject to at least some of the U.S. sanctions.

For Further Information

Please contact our [Global Trade Controls group](#) experts on the Cuba restrictions.

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