NAVIGATING THE CUBA SANCTIONS: DEAL POINTS

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I. Introduction.

A recent project of ours advising a non-U.S.-based hotel chain with American management, accounts and other business in the U.S. provided useful insights in how to structure the hotel chain's new business in Cuba without falling afoul of the U.S. Department of the Treasury Office of Foreign Assets Control ("OFAC") sanctions regime based on the existing Cuba embargo. OFAC sanctions of *approximately $9 billion* imposed in 2013 on French bank BNP Paribas for using the U.S. banking system to clear transactions to an embargoed country showed that U.S. embargos are not to be taken lightly. These deal points should be useful to anyone wishing to do business in Cuba, whether U.S.-based or not, if U.S. contacts, like directors and officers, offices, assets, or use of the U.S. banking system and currency, are present.

The 2015 restoration of diplomatic relations between the United States and Cuba and easing of many features of the over fifty-year old U.S. embargo on trade and travel with Cuba opens up exciting possibilities for both U.S. and non-U.S. businesses interested in doing business there. President Obama's March 20-22, 2016 visit to Havana is highly symbolic of the easing of tensions between the two countries. Nevertheless, the Cuba embargo, and the OFAC sanctions regime for violations of it, remain in place.

While Congressional action will be necessary to remove the embargo, President Obama's actions will ease the path of certain categories of U.S. businesses seeking to operate or invest in Cuba. Moreover, non-U.S. businesses that operate in the U.S and which wish to do business in Cuba, and which were made wary of U.S. sanctions regimes by the nearly $9 billion dollar fine of BNP Paribas, will now have clearer guidelines as to what they can and cannot do without falling afoul of U.S. regulation.

II. The U.S. OFAC Sanctions Regime.

Six separate sets of U.S. federal laws and regulations embargo, and impose sanctions on, trade with Cuba, including the *Trading with the Enemy Act of 1917*; the *Foreign Assistance Act of 1961*, which prohibited aid to Cuba and authorized the U.S. President to impose a trade embargo against Cuba by executive order; the *Cuba Assets Control Regulations of 1963*, promulgated pursuant to the *Trading with the Enemy Act*; the *Cuban Democracy Act of 1992*; the *Helms-Burton Cuban Liberty and Democratic Solidarity (LIBERTAD) Act of 1996*; and the *Trade Sanctions Reform and Export Enhancement Act of 2000*. The Cuban Assets Control Regulations, 31 CFR (Code of Federal Regulations) Part 515 (the "Cuba Regulations," hereafter cited §515.xxx) were originally issued by the U.S. Government in 1963 pursuant to the *Trading with the Enemy Act* to embargo trade with Cuba and, with modifications, notably pursuant to the LIBERTAD Act (with private rights of action provided for in the act subject to revolving six-month suspensions), are in place to this day.

The Cuba Regulations substantially limit visits to, investments in and transactions with, Cuba by persons subject to U.S. jurisdiction. Although other agencies of the U.S. Government have regulations in place

respecting trade with Cuba, the Cuba Regulations are the most relevant to U.S. and non-U.S. businesses wishing to do business in Cuba without falling afoul of the U.S. sanctions regime. Criminal penalties for violating the Cuba Regulations can range up to 10 years in prison, $1,000,000 in corporate fines, and $250,000 in individual fines. Civil penalties of up to $65,000 per violation may also be imposed. The Cuba Regulations have been somewhat liberalized by executive orders during the Obama Administration, notably for telecommunications and health services and travel and remittances to Cuba, but otherwise remain in place despite the improvement in diplomatic relations.

III. Persons Affected and Excluded.

The Cuba Regulations affect all "Persons subject to the jurisdiction of the United States," which is broadly defined. "Person" means an "individual, partnership, association, corporation, or other organization" (§515.308). A "person subject to the jurisdiction of the United States" means: (a) all U.S. citizens and U.S. permanent residents wherever located; (b) any "persons within the United States;" (c) any person (i.e., including corporation, partnership, association or other organization) *organized under U.S. federal, state or territorial law*; and (d) any person (i.e., including corporation, partnership, association or other organization), wherever organized or doing business, *that is owned or controlled by* any person or persons described in (a) or (c). The definition of "persons within the United States" in (b), above, means (1) any person, wherever located, who is a resident of the United States; (2) any person actually within the United States; (3) any person (i.e., including corporation, partnership, association or other organization) organized under U.S. federal, state or territorial law; and (4) any person (i.e., including corporation, partnership, association or other organization) wherever organized or doing business which is owned or controlled by any person or persons described in (1) or (3) (§§ 515.329, 330 (there is some apparent redundancy in §§ 515.329, 330)). However, the determination of "persons" affected by the Cuba Regulations is only part of the inquiry. It is also necessary to review what transactions are within the reach of the Cuba Regulations.

IV. Transactions Affected and Excluded.

The heart of the Cuba Regulations concerns prohibited transactions. "Transaction" is broadly defined in the Cuba Regulations as (a) Any payment or transfer to Cuba or a Cuban national, (b) Any export or withdrawal from the United States to Cuba, and (c) Any transfer of credit, or payment of an obligation, expressed in terms of Cuban currency (§515.309). "Transfer" is very broadly defined to mean any actual or purported act or transaction, whether or not in writing and whether or not done or performed in the U.S., and includes any commercial contract, service, conveyance, sale, etc. (§515.310). The following transactions, if involving Cuba or Cuban property interests, are prohibited by the Cuba Regulations, unless permitted by an authorization or license granted by OFAC:

- All transfers of credit and all payments between, by, through, or to any banking institution wherever located, with respect to any property subject to jurisdiction of the United States or by any person (including a banking institution) subject to jurisdiction of the United States;
- All transactions in foreign exchange by any person within the United States;
- The export or withdrawal from the United States of gold, silver, currency or securities, by any person within the United States;

- All dealings in, including transfers, withdrawals, or exportations, or any property or evidences of indebtedness or ownership of property by any person subject to jurisdiction of the United States;
- All transfers outside the U.S. with regard to any property or property interest subject to jurisdiction of the United States; and
- Any transaction made for the purpose or having the effect of evading the foregoing (§515.201).

To the extent a transaction would be prohibited under §515.201, it is prohibited between any person within the United States and any principal, agent, home office, branch, or correspondent outside the United States to the same extent as if the parties to the transaction were not affiliated or associated with each other (§515.404).

515.201 prohibits any request or authorization made by or on behalf of a bank or other person within the United States to a bank or other person outside the United States as a result of which the bank or person outside the United States makes a payment or transfer to Cuba or a Cuban national (§515.409). In other words, a U.S. bank or person cannot use a third country bank or person as an agent to make payments or transfers into Cuba.

V. Recommended Corporate Structuring.

Although the sweep of the Cuba Regulations' definitions of "persons," "persons subject to the jurisdiction of the United States," and "persons within the United States" is broad and clearly intended to be so, the definitions do ostensibly exclude, for example, corporations not organized under U.S. law that are not:

- physically located within the U.S.;
- owned or controlled by U.S. citizens or U.S. permanent residents wherever located; or
- owned or controlled or by any person (i.e., including corporation, partnership, association or other organization) organized under U.S. federal, state or territorial law.

Under this interpretation, the Cuba Regulations would not govern, on the "persons" level, a non-U.S. company or company organized under the laws of another country that was owned by a non-U.S. company, not physically located within the U.S. and over which no U.S. citizen or resident exercised *de jure* or *de facto* control, and a transaction with Cuba or Cuban nationals would not be prohibited under §515.201 and subject to sanctions by the Cuba Regulations.

To preserve investor/economic interests, partnership with a Cuban or other country company in a cross-border joint venture, whether organized as a corporation, limited liability company, limited partnership, or as a contractual relationship, may achieve the necessary structure under the Cuba Regulations as well as satisfy Cuban foreign investment rules. OFAC regulatory scrutiny may be avoided by having non-U.S.-domiciled "Special Purpose Vehicles" ("SPVs") hold restricted assets and maintain different proportional ownership in another joint venture vehicle (U.S. or non-U.S.) that holds non-restricted assets. In such a case, the restricted asset-holding and other asset-holding entities might be jointly owned by a holding company or "blocking" entity that was in turn owned by the joint venturers.

In such a structure, super-majority voting provisions at the holding/SPV and operating company levels can limit majority votes to routine matters, while giving both the venturers shared control over extraordinary events such

as acquisitions and divestitures, mergers, debt incurrence, raising capital, business plan adoption and liquidation. Through combinations of these mechanisms, investors contributing a majority of the venture's capital or assets can maintain effective control consistent with their expectations while technically being relegated to minority positions required for regulatory reasons. Additionally, the investors' own local tax or regulatory interests may be served by this type of structuring. *See* our advisory *Cross-border Joint Ventures: Deal Points*, July 8, 2015.

VI. OFAC Licensing Procedures.

No matter how sophisticated the structuring to stay on the right side of the Cuba Regulations, it will be prudent to work with OFAC's licensing division. It is possible to apply for both general and special (fact specific) licenses under OFAC, and the staff is forthcoming and helpful, especially when dealing with applicants and their representatives knowledgeable and respectful of the Cuba Regulations. Under some circumstances, when a license is applied for in an abundance of caution, even though an ownership/management/investment structure is being used that apparently is not subject to the Cuba Regulations, the OFAC licensing staff will issue a "Response without Action," the rough equivalent of a Securities and Exchange Commission "No Action Letter," giving the applicant comfort that it is on record as having notified OFAC of its plans, applied for a license, and been told officially that none was required.

VII. Conclusion.

This is an exciting, but potentially dangerous, time for U.S. companies, and non-U.S. companies with U.S. directors and officers, or using the U.S. banking system, contemplating doing business and investing in Cuba. On the one hand, the establishment of diplomatic relations and relaxing of some regulations holds out the promise of the resumption of trade with a populous and well-disposed neighbor ninety miles from Florida. On the other hand, the embargo and OFAC sanctions regime, with its potential millions - even billions - of dollars in bite remains in place and has been recently and devastatingly used. Careful review and application of the OFAC regulatory regime can allow investment to proceed without the risk of sanctions.

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