Published on *The National Law Review* https://natlawreview.com

Telecommunications in Cuba and the U.S. Embargo: History, Opportunities, and Challenges

Article By:

Litigation Practice Drinker Biddle

Since President ***Obama*** announced the ***United States***' new policy to normalize relations with ***Cuba***, talk about opportunities for U.S. telecommunications companies has flourished. That reaction only intensified when the ***Treasury Department*** and the ***Commerce Department*** published amended rules on January 16, 2015, implementing these policy changes, which authorize commercial telecommunications services linking third countries and Cuba (as well as within Cuba), services incidental to Internet-based communications, and the export of communications items.

This is not the first time that the United States has relaxed sanctions on Cuba with the hope of expanding direct communications between the two countries and encouraging change in Cuba. The first attempt took place in 1992 when the ***Cuban Democracy Act*** allowed for telecommunications services between the two countries, but the effects were limited and short-lived. The U.S. relaxed sanctions again in 2009, this time to allow U.S. telecom companies to establish fiber optic and satellite links with Cuba and to enter into roaming agreements with Cuban carriers. Despite hopeful talk about an investment boom, those measures changed little.

The question now is whether the new regulations will achieve what has been elusive for more than two decades. Interest by U.S. entities is understandable given that the newly implemented changes plainly go beyond anything that has been done before. But with the new opportunities come challenges and potential minefields for U.S. investors looking to Cuba. A more sober analysis is in order, particularly one that takes into account the history of U.S.-Cuba telecommunications relations, the state of the telecommunications industry in Cuba today, the potential limitations that come from the statutory framework that continues in effect despite the relaxation of sanctions, and, critically, Cuba's own telecommunications policy.

HISTORY OF U.S.-CUBA TELECOMMUNICATIONS RELATIONS

The history of U.S.-Cuba telecommunications relations is long and contentious. Undersea cables supporting telegraph and telephone service connected the two countries for decades before the Cuban Revolution. International Telephone and Telegraph (ITT), a U.S.-based conglomerate, had a majority interest since the early 1900s in the Cuban Telephone Company, the dominant telecommunications provider on the island.

It all changed after the Cuban Revolution in 1959 and the imposition of the embargo a few years later. The new Cuban government led by Fidel Castro confiscated the Cuban Telephone Company. The U.S. allowed AT&T to use its undersea cable after the embargo, but only if it did not add new capacity to it. This positioned AT&T as the dominant carrier for telecommunications between the U.S. and Cuba through the late 1980s, when the cable finally became unusable and long distance calls from the U.S. to Cuba had to be routed through third parties using satellite uplinks. During that time, and as a result of the embargo, AT&T could not make any payments to Cuba for the origination and termination of long distance calls, depositing them instead in an escrow account. The controversy over the release of these funds became another contentious chapter in U.S.-Cuba relations.

A glimmer of hope emerged in the mid-1990s after the enactment of the Cuban Democracy Act. After long negotiations, Cuba dropped its demand for the release of the AT&T escrow funds and reached an agreement with the U.S. on compensation for terminating calls. The FCC authorized various U.S. carriers to provide direct-dial service to Cuba (via satellite) under guidelines developed by the State Department, and at least one U.S. entity presented a plan to install and operate a new undersea cable between the two countries—the first direct cable since the Cuban Revolution. But both the plans for an undersea cable and direct dialing between the U.S. and Cuba were short-lived. The statutory prohibition on any investment in the domestic telecommunications network within Cuba, which was enacted in 1996, hindered any plans that required connecting an undersea cable to the Cuban domestic telephone network, and the U.S. ultimately did not approve the plans for a new undersea cable.

Direct dial service was shut down in 2000 when the Cuban government suspended the service after the U.S. released the long distance escrowed funds as compensation for damages arising from the Cuban air force shooting down of a Brothers to the Rescue plane in 1996.

Little has changed since then. A U.S. company proposed and received approval under the regulations enacted after 2009 to build and operate a new undersea cable between the two countries, but to this day it has been unable to reach agreement with the Cuban government. Instead, the Cuban government went ahead with a plan sponsored by Venezuela to lay an undersea fiber-optic cable connecting that country to Jamaica and Cuba. This was an interesting—and revealing—move by the Cuban government, since it would have been cheaper (and it would have taken less time) to connect to any of the many international undersea cables that already pass nearby. Cuba, however chose the more expensive cable that bypasses the U.S. altogether.

THE STATE OF TELECOMMUNICATIONS IN CUBA

Domestic Telecommunications

After the confiscation of ITT's property, the Cuban Telephone Company became the Cuban Telecommunications Enterprise (EMTELCUBA) and was placed under the control of the Ministry of Communications, which from its origin and for decades afterwards has been headed by members of the Cuban military. By the 1990s, Cuba's domestic telecommunications infrastructure was at a critical level. The domestic telephone network was mostly an analog telephone network that relied on aging equipment dating to the 1930s with little to no fiber optic backbone, with only 350,000 lines for a population of more than 11 million, and on its way to inoperability.

Change came in the mid-1990s, when the Cuban government partially privatized EMTELCUBA—a dramatic step at the time for a country that had foresworn privatization. Empresa de Telecomunicaciones de Cuba S.A. (ETECSA) was created as an entity separate from the Ministry of

Communications and was granted an exclusive, long-term concession to provide telecommunications services (except for mobile service) in Cuba. Mexico's Grupo Domos Internacional was the original joint venture partner with a 49 percent interest valued at $1.5 billion, and it was joined shortly thereafter by Telecom Italia. But a combination of financial problems (driven largely by the Mexico peso crisis) and pressure from the U.S. government after the enactment of the Helms-Burton Act led to a relatively quick exit by Grupo Domos, which left Telecom Italia controlling 30 percent of ETECSA in a joint venture with various entities Cuban state-owned entities.

The capital injection that followed this partial privatization produced significant improvements. By 2010, switches and landlines across the island had been digitized, the number of landlines had tripled to over 1,000,000, teledensity had increased to 10 lines per 100 habitants, and fiber optic cables were installed throughout the island. In 2011, however, Cuba renationalized ETECSA and a state-owned company with ties to the Cuban military, Rafin S.A., bought Telecom Italia's stake for more than $700 million.

After that transaction, the Cuban government effectively owned the totality of ETECSA, as it continues to do so today.

Mobile Telephony

Mobile telephone service dates back to the early 1990s, when Cubacel was created as a joint venture between the Cuban government and a private entity from Mexico, Telecomunicaciones Internacionales de Mexico S.A. (TIMSA). By 1998, Sherritt International Corp, a Canadian company, had acquired a 37.5 percent stake in Cubacel, leaving TIMSA as a minority stakeholder. Because Cubacel used TDMA technology, the government created a separate state-owned entity, C-Com, to offer mobile service using GSM technology. By 2003 the Cuban government had bought back Sherritt's stake to take complete control of Cubacel, which it then folded into ETECSA (along with C-Com) to consolidate all telecommunications services under a single, wholly state-owned monopoly.

Even with this infusion of foreign capital and the subsequent consolidation under ETECSA, Cuba's mobile telephone infrastructure lags behind that of most of its neighbors. The mobile network has expanded throughout the island and the number of subscribers has increased dramatically, especially since 2008, when the Cuban government lifted the ban on the purchase of mobile devices and reduced sign-up costs and per-minute rates. But Cuba still has one of the lowest mobile penetration rates in Latin America. The cost of receiving and making phone calls is still very high, particularly given the limited disposable income of most of the Cuban population. And the service available to the general population is mostly based on second-generation technology that does not support Internet service (with the more advanced networks limited to tourists, foreign business executives, government officials, diplomats, and foreign news agencies). In other words, significant additional investment, particularly in mobile broadband will be necessary in the ETECSA network for Cuba to catch up and for wireless broadband services to become widely available.

Internet

All Internet connections in Cuba are available exclusively through ETECSA. Because wireless Internet service is not available to the general population, landline Internet effectively is the sole means of connecting people in Cuba to the Internet. The combination of inadequate infrastructure and the government's deliberate policy of controlling access to the Internet have produced extremely slow service that is notwidely available to the population. Government statistics claim that 25 percent of the population has access to the Internet, but it is estimated that only 5 percent of the population has access to the open Internet. That is an important distinction to make when talking about access to the Internet in Cuba: while certain professionals, government officials, and tourists have access to the World Wide Web, most Cubans only have access to an intranet set up by the Cuban government that does not provide open access. ETECSA recently started offering open access via Internet cafes, but at a prohibitive price for most Cubans. Home connections are not available to the vast majority of Cubans, since they require permission from the Ministry of Information and Communication (which is not routinely granted). And whatever access is available tends to be among the slowest in the world. The undersea cable with Venezuela may help in that regard, but the impact will be limited as long as the domestic network supporting Internet access is inadequate.

OPPORTUNITIES . . . AND CHALLENGES

What are the opportunities available to U.S. telecom companies interested in Cuba? The mushrooming of mobile telephony in Cuba points to potential opportunities in the sale of mobile devices, although its potential magnitude is an open question given that Cuba is not a huge market (with a population of 11 million, it does not approach the market size of countries like Vietnam and Myanmar, where the elimination of long-standing sanctions has opened the door to opportunities for U.S. companies) and given the income limitations of the general Cuban population. The dire need for upgrades to Cuba's wireless network and expansion of Internet infrastructure also points to potential opportunities in larger-scale investments and transactions involving telecommunications infrastructure. But the latter category of projects will come with a particular set of challenges for U.S. investors:

Prohibition on Investments in the Domestic Network. U.S. investors looking to Cuba will have to navigate an apparent conflict between the recently adopted rules and the statutory prohibition on domestic investment. The new rules are designed to promote not only telecommunications services between Cuba and the U.S. and other countries, but also within Cuba. The Helms-Burton Act, however, prohibits any investment in the "domestic telecommunications network within Cuba," which includes making any contribution of funds or making any loans to or for such a network. This raises questions as to what qualifies as the "domestic telecommunications network" in Cuba. Is the wireless network originally developed by Cubacel a "domestic telecommunications network" for the purposes of the statute? Would a new wireless network constitute a "domestic telecommunications network"? Are all the components of the ETECSA landline network part of the "domestic telecommunications network"? Even if the term "domestic telecommunications network" is read narrowly to refer to the legacy ETECSA landline network, where does that leave the wireless network projects that will require using or leasing facilities from that network or investing in equipment to interconnect to that network? It may be difficult, if not impossible, to promote investments in telecommunications within Cuba when the law simultaneously prohibits investments in Cuba's "domestic telecommunications network."

Exposure to Confiscation Claims. Potential U.S. investors will also have to consider the potential liability created by transactions involving confiscated property of U.S. nationals. To avoid violating 22 U.S.C. § 6033(a), any transaction or joint venture that requires investing in, or providing service through, the legacy ETECSA landline network would have to steer clear of extending any financing. Any such transaction could also open the door to future civil claims by those U.S. nationals that control portions of ITT's confiscation claim (or the claim of other investors in what was then the Cuban Telephone Company). This risk—and the potential additional costs involved to deal with it—was illustrated by Telecom Italia's experience with its joint venture with ETECSA. When Telecom Italia acquired its stake from Domos in the 1990s, it entered into a separate agreement in which ITT waived claims against Telecom Italia for the use of its confiscated property in Cuba in exchange for a one-time lump sum payment. U.S. investors will need to consider this exposure—and the potential additional costs involved—before making any investments in the legacy ETECSA landline network.

Partnering With the Cuban Military. From the time that ETECSA was partially privatized in the 1990s, investing in Cuba's telecommunications infrastructure has required entering into joint ventures with entities controlled by the Cuban military. ETECSA itself is owned by a number of state-owned entities, about which little is known with certainty. One of these entities, Rafin S.A., appears to be a subsidiary of Grupo de Administración Empresarial (GAE), the holding company for various corporations and other business ventures controlled by the Cuban military. Another one of these entities, Banco Financiero Internacional, is a subsidiary of CIMEX, afinancial-commercial conglomerate that also reportedly has strong ties to the military. A joint venture involving investment in Cuba's existing telephone network would likely require teaming up with one of these entities. Even if a prospective transaction or project in Cuba's telecommunications sector does not directly involve contracts with or payments to these particular entities, it will almost certainly require a joint venture with one of the many other state-owned entities controlled by the Cuban military. And that is where the uncertaintyand risk will lie for the prospective U.S. investor: the lack of transparency when dealing with state-owned entities in Cuba will likely make it daunting to determine who are the real stakeholders of the joint venture. That uncertainty, in turn, could increase the exposure of U.S. companies to violations of the Foreign Corrupt Practices Act and the various money-laundering statutes that apply to U.S. companies in international joint ventures. Thorough due diligence on these matters will be essential to any U.S. investor thinking about taking advantage of the new rules.

The biggest challenge to potential U.S. investors may not come from U.S. rules andstatutory requirements, however. It is likely to come instead from the ultimate unknown when it comes to Cuba: whether the Cuban government is actually interestedin promoting U.S. investment in the telecommunications sector. A few issues for potential U.S. telecom investors to consider:

Barriers to Entry in the Telecommunications Market. The threshold obstacle to any investment in Cuba's telecommunications infrastructure is that thetelecommunications sector is subject to a complete state monopoly and is not open to foreign investment or competition. Significant private investment in the telecommunications sector has historically materialized in countries that have liberalized their telecommunications market. Today, Cuba is at the other extreme. Not only is the entire Cuban telecommunications sector agovernment-regulated monopoly with exclusive licenses and strict barriers to entry, but Cuba renationalized it after years of allowing some private investment. This model of complete government control over telecommunications is an anomaly today in the developed world and a barrier to the kind of boom in investment that is being widely predicted. Any realistic prospects for U.S. investment in Cuba's telecommunications infrastructure will first require some liberalization of the market, particularly as it relates towireless services. Until that happens, opportunities beyond the sale oftelecommunications equipment to individuals may be limited.

Tenuous History of Private Investment in Cuba's Telecommunications Sector. The history of private telecommunications investors in Cuba should be a warning sign to U.S. entities looking at joint ventures in the Cuban telecom sector. The private joint ventures of the 1990s did not end well. The ETECSA joint venture ended in a fall out and mutual recriminations between Groupo Domos, the original investor, and the Cuban government. By 2010, Telecom Italia was looking to pull out, which it did a year later as part of Cuba's renationalization wave. On the wireless side, Sheritt also ended up selling its stake in Cubacel to the government in a deal that was described as "the prerogative of the Cuban government." These fall-outs and the renationalization of the telecommunications sectors were not isolated incidents. At the time foreign investors in other industries were leaving Cuba in the midstof disputes with the government and criminal crackdowns. Since Raul Castro took over from his brother as president, Cuba’s policy has been to bring the telecommunications sector under tight state control. And in a worrisome sign, Cuba’s recent revamp of its foreign investment law did not identify foreign investment in telecommunications as a priority. Potential U.S. investors will have to navigate the challenges of investing in a country where, as one observer put it, investors “stay happy as long as arbitrary decisions of the Cuban state do not affect their best interests.” In a sector that the Cuban government is intent on controlling, that may prove to be difficult.

History tells us that, sooner or later, a drastic upgrade to Cuba’s telecommunications infrastructure will be on the cards. And there is reason to be optimistic that, in the long run, U.S. entities will drive that upgrade. In the short term, however, the challenges and the unknowns may give them reason to pause or, at a minimum, carefully consider the risks.

National Law Review, Volume V, Number 65