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## Notes on the Categories of Foreign Investment in Cuba

Natacha Teresa Mesa Tejada  
*University of Havana*

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**NOTES ON THE CATEGORIES OF FOREIGN INVESTMENT IN CUBA**

*Natacha Teresa Mesa Tejada\**

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**INTRODUCTION**

The opening of Cuba to foreign capital took place in 1982, with the enactment of Decree-Law 50 “On Economic Association Between Cuban and Foreign Entities,” the first legislation addressing foreign investment in Cuba after the revolutionary triumph of 1959. According to several authors the first mixed-ownership enterprise was founded in 1987 in the tourism sector.

The Cuban Constitution was reformed in 1992. One of the modifications was in Article 23, which recognized mixed enterprises, corporations, and economic associations constituted according to the law, and in exceptional cases recognized the transmission of state property to economic objectives, in order to promote the development goals of the countries, provided that these did not affect the political, social, and economic foundations of the State.

In 1995, the first Law of Foreign Investment was enacted in Cuba, marking a step forward in this area. Based on accumulated experiences, its purpose was the constitutional recognition of mixed-ownership enterprises and to continue promoting the investment of foreign capital

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\* Dr. Natacha Teresa Mesa Tejada is an Associate Professor of the University of Havana.

in the country, in order to strengthen its capacity and economic development. Numerous international economic associations were founded under this law, which over time was supplemented by a series of legal provisions rendered by the Executive Committee and other bodies.

On April 18, 2011 the Sixth Congress of the Communist Party of Cuba approved the Guidelines on the Economic and Social Policy of the Party and the Revolution, which would serve as the guiding document for the process of updating the country's economic model. They recognize the need to attract foreign investment in order to achieve various goals such as: access to technology, import substitution, diversification and expansion of export markets, development of new sources of employment, contribution of medium- and long-term financing, and encouraging the continued participation of foreign capital, as a complement to the national investment effort.

In this way, on March 29, 2014, almost 20 years after the promulgation of Law 77/95, and as part of the modernization of the economic model, a special session of the National Assembly approved the new Law 188 of Foreign Investment: with the objective of adjusting the current regulations for foreign investment to present conditions. This law, unlike its predecessor, is characterized by a regulation and other legal provisions issued by various bodies in the central State administration, which facilitate its application.

The development of foreign investment has an important role in achieving the economic development that Cuba so greatly needs, hence it is considered an active element for the development of some sectors.

## I. CONSIDERATIONS REGARDING THE MIXED ENTERPRISE

Several subjects are presently involved in the Cuban economic scenery, some of which have a long tradition in the Cuban business system, while others do not. The mixed enterprise [*empresa mixta*]—also known as *sociedad de economía mixta*, *sociedades mixtas*, *sociedades de capital mixto*—traces its origins to the 1980s, with the passing of Decree Law 50 on February 15, 1982, “On Economic Association Between Cuban and Foreign Entities,” the first legislation regulating foreign investment in Cuba. That is not an exclusive subject to Cuba, but instead has a long life and has been addressed by many authors in current doctrine. In the words of Brewer Carías, it has the enormous importance of having been the initial means of State intervention in the economy.

Both Decree Law 50 and Law 77 “On Foreign Investment” of September 5, 1995, as well as the recently enacted Law 118 “Of Foreign

Investment,” provide that the mixed enterprise shall be a corporation. In this sense, a question arises among jurists as to whether it should be a public or private corporation.

The majority of authors consider the mixed enterprise a kind of public company. However, Alonso Ureba, Pino Abad, Ariño Ortiz, among others, depart from the traditional view of the public company and instead call it a *company with public participation*, a term that we also adopt. We consider that the choice between one term and another is not a merely semantic problem, given that when we speak of a public company we are referring to one run entirely or mostly by the State or some public entity. In a company with public participation, as its name indicates, the shares of public and private capital are roughly equal. That is to say, there will not be an abysmal imbalance in the economic participation of each of its members.

These companies are formed for many reasons: to promote or develop certain economic sectors lacking private initiative; to coordinate business collaboration between the public and private sector in certain activities; to save private companies from financial disaster whose economic activities represent sources of economic interest and whose disappearance would cause great consequences for the national economy.

Doctrine consistently indicates that mixed enterprises function as corporations. They are regulated by private law, although, precisely because of the involvement of the State or a public entity, it becomes very difficult to escape the application of public law, which in a greater or lesser degree can modify the normal conditions of the corporation.

## II. CHARACTERISTICS

For any analysis involving the mixed enterprise, it is useful to take as a starting point the relevant characteristics established by Cuban legislation and practice, as well as its principal theoretical aspects. First, it is necessary to return to the previous statement regarding the term *mixed enterprise*, which is not common, as each country has its own label. However, among the most used are: mixed company [*sociedad mixta*] and mixed-economy company [*sociedad de economía mixta*].

In our judgment, Randolph Brewer offers the most complete analysis of mixed-economy companies. He defines them as associations with public and private capital for the exploitation of a commercial or industrial activity, and sets forth a group of characteristics that define them, which we also share: companies formed by public capital (provided by the State or a public entity) and private capital. Both capitals generally

share the management of the company, although usually with a preponderance of public interests.

In Cuban doctrine these figures have received scant attention. The distinguished Cuban mercantilist Dávalos Fernández analyzes them and offers a characterization that does not differ in essence from the descriptions offered by international doctrine. He finds the following distinctive elements: two or more partners from different countries, the joint action of partners, a specific objective, participation in the contribution, risks, and benefits, as well as in financial control, transfer of technologies, and agility and flexibility in adapting to the requirements of legislation.

Regarding the establishment of this kind of company, the previous author indicates that they will be composed “by two or more partners of different countries.” The doctrine recognizes that mixed enterprises are composed of public and private capital; this is a feature that distances Cuban mixed enterprises somewhat from international trends. In our context, the mixed character of these companies does not refer to the type of capital, that is, whether it is public or private, but rather to nationality, that is, whether it is domestic or foreign. Our Law is very clear in this respect, stipulating that the domestic investor will be a legal person that will generally be public, (this—we consider—is due to the non-recognition of the private entrepreneur as an essential element of the Cuban economic system) while the foreign investor can be public or private. In this sense, it is valid to point out that the Cuban legislature has taken a step forward by making a broader formulation of the national investor, one not restricted to state enterprises or entities as in previous law. Under the current law of foreign investment, Law 118 provides that “the domestic investor shall be a legal person with Cuban nationality, domiciled in the national territory that participates as a shareholder in a mixed enterprise or party to an international economic partnership agreement.”

Another thing this definition makes clear is that there is no place for natural persons to act as domestic investors. In this regard, we are of the opinion that this feature distances our mixed enterprises from the traditional postulates that concentrate on the mixed character of such companies with public and private capital. Law 118, which regulates foreign investment in our country, offers in Article 2, subsection (h) the following definition of a mixed enterprise: “Cuban commercial company that adopts the form of a corporation with registered shares, in which one or more domestic investors and one or more foreign investors participate.”

The following characteristics can be gleaned from the preceding regulation: *Cuban commercial company* must be understood as one formed in this country; *adopts the form of a corporation with registered shares* raises the question, what factors in Cuban practice support the exclusive adoption of the corporation? Perhaps we may find support in the fact that the corporation's versatility makes it a form capable of adapting to the economic dimensions of each company. Although this form was conceived for large businesses, it can be used for small and medium-sized business as well. We will not dwell on this characteristic in detail, we only want to make clear that, in our judgment, the current Cuban economic environment could adopt other corporate forms, such as the limited liability corporation, given that the characteristics and operations of our mixed enterprises more closely resemble those of a limited liability corporation than those of a traditional corporation.

Article 14 of the Law of Foreign Investment introduces other characteristics for mixed Enterprises, among which we can point out:

(a) *Division of capital in registered shares.* Bearer shares were eliminated by Law 498 of August 19, 1969, in Article 70.

(b) *Freedom of the partners to determine the participation in social capital.* This characteristic shows the flexibility of the law, since the partners can decide freely what economic participation they will have in the company. However, a practical study realized by the author showed that the majority of mixed enterprises in our country are composed by two partners, and a significant number of them have equal participation in the social capital.

(c) *Restriction on the free transmission of shares.* Article 14.7 of the Law of Foreign Investment establishes the impossibility of changing partners without the previous agreement of the parties and the proper approval of the authority that originally granted the authorization when the mixed enterprise was created.

The precept in question is a restriction on the free transferability of shares that distinguishes the corporation, which is not expressly prohibited, but by limiting the mobility of the partners, is restricted. The restriction of the free transfer of titles of value confers a closed character upon Cuban mixed enterprises and situates them, consequently, within the category of closed corporations. On the other hand, through this characteristic we can observe the introduction of control mechanisms by the State. We consider this state intervention relevant since it is one of the methods the State possesses to ascertain who are the foreign investors.

(d) *They are formed and operate under the government's system of authorization.* Cuban mixed enterprises need governmental authorization

to be formed, as established in Article 14.4. In addition to the traditional requirements for the formation of corporations (partnership agreement, public instrument, and bylaws), the corresponding approval and authorization by the Council of States or Council of Ministers is also and indispensably required in order to be entered into the Commercial Registry [*Registro Mercantil*]. It is important to clarify that this authorization is not only for the purpose of business formation; the law also requires authorization to change partners, extend the period of duration, as well as perform any activity that would alter the original conditions.

Government approval is a guarantee for the country, as it allows it to avoid the presence of inconvenient partners, withdraw capital, and trade shares. This topic goes beyond legal frameworks. Its foundation can be seen in political and economic questions which we must not ignore precisely because of the characteristics of Cuba.

Another element that characterizes the Cuban mixed company, and comes about as a consequence of its distinguishing features, is the high possibility of conflicts between partners that result in corporate gridlock at the shareholders meeting. To avoid this type of crisis, jurists must introduce clauses in the formative documents with the preventative goal of preserving the company. The occurrence of such paralysis in a mixed enterprise is resolved through judicial dissolution of the corporation, hence the need to establish clauses to prevent corporate deadlock.

Commercial doctrine is consistent about certain clauses to prevent corporate deadlock, which I consider perfectly applicable to the bylaws of Cuban mixed enterprises: submitting the conflict to negotiation; establishing tie-breaking mechanisms ranging from the rotation of the final decisions, raffling or drawing names [*el sorteo o insaculación*], or the referral to qualified third parties; specific clauses allowing the departure of the partner, determining the respective valuation of the social part and, accordingly, the payment of the due price.

With the preceding in mind, we may affirm that Cuban mixed enterprises have a set of unique defining characteristics, both from a legal perspective as well as a practical one: they are composed of domestic and foreign capital; they must take the form of corporations; they generally have a small number of partners; they have a fundamentally equal economic participation and are regulated by private law. On the other hand, we have observed the introduction of state control mechanisms that will have repercussions on their characteristics. They are closed corporations and subject to the system of government authorization.

### III. CUBAN MIXED ENTERPRISES: THEIR OPERATION

As corporations, mixed enterprises in Cuba have a corporate organizational structure, assuming a one-tiered system of administration, whose corporate bodies are: board of directors [*órgano de administración*] and shareholders meeting [*junta de accionistas*], an organizational structure in which the effects of state intervention are felt.

As in the traditional corporation, the shareholders meeting is the supreme body wherein corporate decisions are made by majority vote. Because mixed enterprises are composed of two or more shareholders, who own public and private capital, the agreements are adopted by the shareholders or their representatives jointly. We are of the opinion that this body is limited in its scope of action, since it does not have total freedom to execute agreements once they have been made, because the majority of the substantial issues for the functioning of the corporation require government authorization. It is not enough for the partners to adopt an agreement in the board, they must also obtain state approval. The agreement is only executed once the authorization is granted and it is entered into the Commercial Registry.

The board of directors is the executive of the corporation in charge of its management and representation. In some cases, mixed enterprises have an operational level in charge of the day-to-day affairs of the corporation that tends to supplant the role of the board of directors. This operational level is known as management [*gerencia*], and cannot be considered a corporate body. It has no legal foundation and is established, in some cases, in the bylaws, while in other cases it is born of the companies' practice without any statutory regulation.

Another characteristic of the board of directors, a consequence of the closed nature of mixed enterprises, is that in many cases the members of that body are also shareholders. This can lead to possible overlap of the two bodies' operations in these companies.

### IV. INTERNATIONAL ECONOMIC PARTNERSHIP AGREEMENTS

In the legislative development of foreign investment in Cuba, both Decree Law 50 of 1982 and Law 77 of 1995, as well as Law 118 of 2014, recognize international economic partnership agreements as a category of foreign investment.

The international economic partnership agreement is, as its name indicates, a voluntary agreement between domestic and foreign investors to act in international economic partnership, without creating a legal

person. I consider it necessary to highlight this first element, because unlike the mixed enterprise, the international economic partnership agreement does not create a new legal person distinct from the parties. It is an agreement for collaboration. The parties are free to request permission from the relevant authorities for the object of the contract they wish to perform, and once they receive authorization they can execute it.

They are generally long-term contracts, which is why it is necessary for the parties to include all necessary clauses, so that the contract will be as complete as possible in order to allow its effective execution. The only limits are the provisions of the authorization, the authorized contractual objective, and current legislation.

Article 15 of the legal text sets out the following characteristics of these contracts: (a) they do not create a legal person distinct from the parties; (b) any activity contained in the authorization may be performed; (c) the parties are free to stipulate all the agreements and clauses they deem to be in their interests, so long as they do not infringe the authorized object, the conditions of the authorization, or current legislation; and (d) each contracting party makes separate contributions that form an accumulation of shares of which they are always the owners, and although not constituting a social capital, they may form a common fund, provided each portion of the ownership is clearly determined.

It is also an international contract, a characteristic not mentioned in Law 118. As such, one of the clauses that must form part of the content of these contracts is the applicable law. We consider it useful to reflect on which can be the applicable regulation in these contracts. We are of the opinion that, as provided in the Law of Foreign Investment, the provisions of Decree Law 304 of November 1, 2012 may be applied if the parties expressly so agree.

In the absence of an agreement by the parties, whether express or implicit, the provisions of the Civil Code will be applied if the contract is executed in Cuba, as Article 17 of the substantive rule. In the same way, the principles of UNIDROIT (International Institute for the Unification of Private Law) may be applied to these contracts, an expression of the harmonization of international contract law.

It is not a contract in which there will be remuneration of the parties, but rather each of the partners will contribute to a common fund. For this reason, it is necessary to determine in the content of the contract the quality of the contributions to be made, so that at the end of the contract the initial contributions return to their owners. It is in turn a formal contract, given that it requires a notarized public document and entry into the Commercial Registry in order to become effective.

The limitation on freely transferring one's contractual position weighs heavily on both foreign and domestic investors, as all parties to the contract need the approval of the corresponding authority.

Law 118 makes some modifications with respect to the repealed Law 77, one of which groups under the classification of international economic partnership agreements some contractual forms that, after the enactment of Law 77, were recognized as categories of foreign investment by Agreements of the Executive Committee and Council of Ministers (CECM). It addresses hotel management contracts (the written agreement between the owner of a hotel and a professional hotel management company, by which the manager accepts the responsibility conferred by the owner of assuming the efficient administration and commercialization of the services offered by the hotel, in exchange for the payment of fees and without transferring any property rights of the hotel), production management contracts, or service contracts (the contract by which a Cuban company or legal person or corporation with totally Cuban capital, hires a foreign legal person to administer one or several lines of production, a production or service facility, or a part of these activities, for a specific period, in exchange for a mutually agreed payment, conditioned upon the results of the management corresponding to agreed-upon indicators), as well as professional service contracts. International economic partnership agreements also include contracts for the exploration of non-renewable natural resources, construction contracts, and agricultural production contracts.

It is valid to point out that the express and legal recognition of these forms of contract under the classification of international economic partnership agreements is not a closed list, but rather the legislature clearly established that "these are classified as international economic partnership agreements, *among others* . . . ." We consider this to have been positive, since the practice is very rich and making an exhaustive list of the types of contracts that make up the aforementioned category would reduce the possibility of entering into international economic partnership agreements not specified by the law.

Another modification introduced by the present Law of Foreign Investment is a varying level of approval for these contracts. Under the repealed Law 77 the approval of these contracts was a role of the Executive Committee of the Council of Ministers. Today it is one of the functions of the Ministry of Foreign Trade and Investment and of the Ministry of Tourism to approve or reject these contracts according to an agreement adopted by the Council of Ministers. In the specific case of

professional service contracts, it establishes that the Cuban party should request authorization by the Comptroller-General of the Republic.

## V. WHOLLY FOREIGN-OWNED ENTERPRISES

Unlike the two categories previously analyzed, the origins of the wholly foreign-owned enterprise are in Law 77. This category of foreign investment is characterized by the absence of a domestic investor, and consequently domestic capital. Only the foreign party participates in its management and representation, receives the exclusive benefits, and complies with all obligations that arise from it. It can be a legal person or a natural person.

As the Law of Foreign Investment establishes in Article 16, paragraph 2, the foreign investor can be established in the national territory as a legal person or as a natural person. There are two possibilities when the foreign investor is a legal person:

The first possibility is to create a Cuban affiliate (*una filial cubana*) of the foreign company. In this sense, the law expressly provides that the affiliate must adopt the form of a corporation with registered shares. It is not idle to point out, although there are still confusions in the practice, that the affiliate of a wholly foreign-owned enterprise will always be Cuban, because it has been formed in Cuba, and therefore is a Cuban affiliate of a foreign company. We would like to call attention to the fact that the law requires the form of a corporation both for the mixed enterprise as well as for the Cuban affiliate of the wholly foreign-owned enterprise.

In this sense, we are of the opinion that, if the country is urged to achieve sustainable economic development and one of the means to achieve this is through foreign investment, the requirement that the corporation be the only form used in Cuba could be unappealing to a foreign investor with a project of interest for the country who attempts to establish a Cuban affiliate of a wholly foreign-owned enterprise. If the latter is a corporation sole (*sociedad anónima unipersonal*) or limited liability corporation (*sociedad de responsabilidad limitada*), and the investor wishes to maintain that same corporate structure in its Cuban affiliate, is it legally possible to do so? The answer is negative, given that the Law of Foreign Investment establishes the obligatory nature of adopting the form of a corporation, and in our country the corporation sole does not have legal support. Article 116 of the Commercial Code establishes that “the company contract by which *two or more* persons are obligated to put assets into a common fund, industry, or anything to

obtain profit, will be commercial whatever its class may be, so long as it has been formed in accordance with the provisions of this Code.” In the author’s opinion, the possibility should be analyzed of making this requirement more flexible, as she does not find reasons to continue this obligation, especially when the attraction and fostering of foreign investment in order to invigorate social and economic development today are among our country’s goals.

The second possibility for a foreign investor that, as a legal person, seeks to be established in the national territory is through the establishment of a Subsidiary (Sucursal) of the foreign entity. This is a topic that in current Cuban practice becomes a bit controversial due to the existence, at the time of the publication of this Essay, of two types of subsidiaries (those regulated by Decree 206 of April 10, 1996, of the Council of Ministers, which exist essentially to carry out foreign trade, and those regulated in Law 118/14).

I have some ideas that will clarify what are the main characteristics of subsidiaries. “The subsidiary is a secondary establishment, *lacking legal personhood*, that is permanent, with the same objective as the principal establishment, but different facilities and clientele, that enjoys operational autonomy through a manager with sufficient powers to perform its function, although subordinated to the directives of the central administration, without affecting the assets (*unidad patrimonial*) of the company.”

It possesses the following characteristics: form of territorial expansion, lacking legal personhood with respect to the principal establishment, legal and economic dependence on the parent company, it does not possess its own assets, it has permanent representation which must be both in the time and territory in which it is located, with internal self-management: although it is economically and legally dependent on the principal establishment, it has its own means to carry out the activities of the parent company in its territory, which enables it to create its own clientele.

The subsidiaries regulated in Law 118 and supplementary provisions present a somewhat more flexible system. Once authorized, they are entered into the Commercial Registry.

Another possibility for the foreign investor of a wholly foreign-owned enterprise attempting to establish himself in Cuba through foreign investment is as a natural person, that is, acting for himself, which is known in commercial doctrine as an individual commercial entrepreneur (*empresario mercantil individual*).

## CONCLUSION

The mixed enterprise is a part of the Cuban business system without state management. Its existence in our economic system dates back almost three decades after the triumph of the 1959 revolution, and it still remains important in Cuban commercial traffic. It has its own characteristics, some of which depart from the traditional precepts that characterize these entities. They are influenced by mechanisms of state control that, although in some cases are necessary, in others are excessive. As a result, they must maintain a balance and be flexible in some aspects, so that State intervention does not become excessive and distort or endanger the functioning of Cuban mixed enterprises, or limit the autonomy of the partners.

International Economic Partnership Agreements maintain their essence as modalities of foreign investment. Various types of contracts have been unified in one legal body, after the enactment of Law 77 opened the door to new types.

Unlike mixed enterprises and international economic partnership agreements, the wholly foreign-owned enterprise is a recent category in Cuba. According to published statistics, today wholly foreign-owned enterprises represent 5%, which demonstrates that this figure is not commonly used, from which we may conclude that like all other foreign investment modalities it is evaluated case by case.

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