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PREPARED REMARKS (subject to editing)

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John S. Kavulich
President

Good morning…..

The New Relationship With Cuba… Challenges & Opportunities… Does It Include Infrastructure Development?

Cuba requires significant Foreign Direct Investment (FDI) in infrastructure; perhaps US$30 billion. There is a question as to how to pay for it and then how to profit from it.

The IBOT model (Investment, Build, Operate, Transfer) may be workable.

Cuba is an 800-mile long archipelago with 2,200 miles of coastline. Longer than the State of Florida; all of the Caribbean Sea-area countries could fit into it. With a population of 11.3 million, it would rank between the states of Ohio and Georgia.

Telecommunications remains problematic; with 11 per 100 citizens having access to a landline and 23 per 100 citizens having access to wireless. Companies from China constructed the fiber-optic backbone network and were involved with the "ALBA-1" undersea cable to Venezuela.

There are 38,000 miles of roads; 21,000 miles of highways (6,290 paved and 7,391 gravel). 800 gas stations; 120 located in Havana. The country produces 50,000 barrels a day of ethanol.

9,270 miles of railroad- with the same gauge as in the United States, so a railcar could travel from Chicago to Miami, upload to a ferry, arrive in Havana and then continue on to Santiago de Cuba. The sugar cane sector uses 2,900 miles of track.

Modernization of highways and railroads are estimated to cost US$20 billion.

There are 70 ports of which 39 can service international imports and exports. 31 have cargo operations. A new Free Trade Zone and port at Mariel, located approximately thirty miles from the city of Havana, is a US$1 billion investment primarily by the government of Brazil.

Eventually, the facility is to encompass 180 square miles and have an annual capacity of up to four million cargo containers. PSA International of Singapore manages the facility, which was constructed by Brazil-based Odebrecht. With 60ft channels and 700 meters of berth, the facility can accommodate Super Panamax vessels.

The port of Havana is 11 meters deep and unable to be altered due to a vehicle tunnel. The facility has an annual capacity of 350,000 containers.

There are ten international airports. The Jose Marti International Airport in Havana has one 13,000ft runway and three terminals. The facility is antiquated. There are eight military airports.

Electrical demand and distribution are increasing. An important question for energy companies is who will buy the kilowatt hours and who will pay for the kilowatt hours. Most existing power is 3-phase, 120 volts. Compatible with United States equipment.

Cuba's Union Electrica has a total capacity of approximately 6.2 gigawatts from all existing sources. There are 14 electrical plants with a total generating capacity of 3.1 megawatts.

This year, Russia-based Inter RAO signed a contract to provide four 200-megawatt generators. The funding is reported to be sourced in Russia. In 2014, a Russia-based RusHydro signed a memorandum of understanding to install hydroelectric facilities.

Today, Cuba's oil wells produce heavy, high-sulfur content oil which is primarily used for energy production. Approximately 25 million barrels annually.

Cuba receives approximately 100,000 barrels of oil per day from Venezuela, representing approximately 50% of current requirements.

Cuba's Energas, a venture between Cuba government-operated Cupet and Canada-based Sherritt International Corporation produces approximately 600-megawatts primarily by harnessing burned-off gas.

There are 200 mining deposits- copper, lead, zinc, gold, chromite, magnesium, nickel (which has decreased substantially in price this year) and cobalt. Cuba has 27% of the world's known nickel and cobalt deposits. 53 active mining operations. 6 major cement plants with a combined capacity of 5.3 million metric tons annually. 11 brick plants.

Cuba has 290 large-scale factories producing (or assembling) cranes, engines, steel containers, elevators, railway cars amongst other products. Textiles, clothing, metals, machinery and transportation equipment manufacturing have decreased by more than 50% during the last two decades.

Renewable energy production (solar, wind and hydro) is important, perhaps critical, for the country to re-establish its manufacturing capabilities. Perhaps 70% of renewable energy could be derived from sugar cane bagasse.

Cuba has a goal of constructing by 2030 thirteen wind farms to produce 633-megawatts. 700-megawatts of photovoltaic parks, 19 bio-electric generation operations (using sugar cane bagasse) to generate 755-megawatts, and 74 small hydroelectric facilities to generate 56-megawatts.

There are plans to install 200,000 solar heaters in residences, healthcare facilities, and industrial plants.

This month, the Abu Dhabi Fund for Development agreed to provide a concessionary loan of US$15 million to create 10 megawatts of solar energy projects in Cuba.

There are critical issues with Cuba's water system. Rivers need to be dredged and connected.

Solid waste water treatment upgrades and new facilities are required for the hospitality sector and for manufacturing.

When President Obama addressed the nation in December 2014, he wore a dark suit, stood at a podium, and spoke for fifteen minutes.

When President Castro addressed his nation the same day, he wore a military uniform, sat at a desk, and spoke for five minutes.

<u>Optics matter</u>.

President Obama solidified a legacy- he took a chance, mended country relationships, removed some imagery issues, and created focuses upon United States policy towards Cuba, Cuba policy towards the United States, and the commercial, economic and political landscape existing within Cuba. Which leaves us where?

The initiatives proposed by President Obama (some of which were unsuccessfully attempted by predecessors) are designed to tear at the social fabric of Cuba; with a goal of recreating a middle class and a professional class abridged by the 1959 Revolution… a challenging landscape today defined by those who have (through earnings or remittances) and those who have not.

President Obama's message… *Create your worth as opposed to the government of Cuba determining your worth. Be what you can, what you want... not what you're told to be*.

So what has the government of Cuba agreed to or done since December 2014:

- Re-establish diplomatic relations
- Re-open its embassy in Washington, DC
- Authorize the re-opening of the United States Embassy in Havana
- Continue to <u>decrease</u> food product/agricultural commodity purchases authorized by the Trade Sanctions Reform and Export Enhancement Act (TSREEA) of 2000; down approximately 44% during the last eleven months

- Increase healthcare product purchases authorized by the Cuban Democracy Act (CDA) of 1992. Healthcare product exports (cash-only with verification requirements) permitted by the CDA have increased nearly **fourfold** thus far in 2015 compared with 2014
- Authorize a direct correspondent banking agreement with Florida-based Stonegate Bank
- Authorize Cuba government-operated Banco Popular de Ahorro to establish lines of credit up to US$400.00 for licensed independent businesses; but continue to prohibit the entities to import products directly, requiring purchases through government-operated companies
- Creating a uniform commercial code and mortgage regulations
- Authorize a roaming agreement with New York-based Verizon Wireless
- Resumption of direct long-distance telephone service through New Jersey-based IDT Corporation
- Not disrupt the in-country and out-of-country operations of California-based Airbnb
- Discuss the re-establishment of regularly-scheduled commercial airline service (Civil Aviation Agreement)- although this has been complicated by issues of reciprocity and by the self-preservation interests of currently-operating charter companies
- Agree to a (limited) resumption of United States Postal Service operations
- And permit a substantial revenue increase from United States visitors (charter flights, pleasure craft, general aviation aircraft, and third-country transit). Thus far in 2015, United States visitors to Cuba, who have the highest net profit margin per person of any visitor to the country, have increased approximately almost 50%.

And what has the government of Cuba not (or perhaps not yet) agreed to or done since December 2014:

- Authorize ferry services
- Authorize United States companies to export products directly to the 200+ categories of licensed independent businesses
- Authorize use of credit cards (although this has substantial compliance issues for United States financial institutions; New York-based MasterCard has removed its "*block*" on credit cards issued by United States financial institutions using its brand). There are approximately 3,000 points of sale in Cuba.
- Authorize United States companies to have an operational presence (including hiring Cuban nationals, obtaining office space, establish bank accounts)
- Authorize United States businesses to engage in loan and lease programs to licensed independent businesses
- Confirm itineraries for all commercial vessels operating people-to-people programs
- Purchase communications/telecommunications equipment or permit the provision of internet services (California-based Google & Facebook), although there are security, pricing and sourcing reasons not to purchase the equipment or permit the provision of such services
- Respond in a timely manner to inquiries from United States companies

Since December 2014, the government of Cuba has successfully marketed to the world changes by the Office of Foreign Assets Control (OFAC) of the Department of the Treasury and Bureau of Industry and Security (BIS) of the Department of Commerce.

The aspirational interest (purported or actual) of the United States business community is **chum** exhibited to governments, financial institutions, agencies (especially those which provide export credit guarantees) and companies. Important to distinguish aspirations from rational analysis.

Visits to Cuba by Members of Congress, Governors, trade organization members, advocacy group supporters, company representatives, and sole proprietors have increased. None have resulted in payments by Cuba for any of the newly-authorized exports from the United States.

But why? Citizens of Cuba have one of the highest awareness of United States brands and one of the highest preferences for United States products.

Using the new and revised OFAC and BIS regulations announced in September 2015, the government of Cuba has embarked on a far more ambitious and consequential marketing campaign- and the United States business community has morphed from chum to individual sector lures. From ladled out of a bucket to artfully displayed in a tackle box.

Despite resistance from the government of Cuba, President Obama should remove existing regulatory restrictions upon Cuba using the United States Dollar for international transactions; the restrictions create burdens for United States companies making payments to Cuba and receiving payments from Cuba.

There is expectation amongst some observers that increasing visits to Cuba by high-level officials of the United States government will create pressures upon the government of Cuba by current substantive commercial partners- they will urge the government of Cuba to re-engage with the United States so that they may see a more timely and meaningful financial return on their commercial dealings. Eleven months has passed with no demonstration of urgency by the government of Cuba.

What the United States may perceive as engagement is perceived by the government of Cuba as weakness and as bait to be used to hook interest from other countries- at the expense of the United States. One need only to view the list of visitors this year to Cuba- heads of state, prime ministers, delegations led by ministers….

And the government of Cuba has reiterated, most recently through statements by President Castro and Minister of Foreign Affairs Rodriguez, that before a normalized relationship will exist, reparations valued from US$121 billion to US$1 trillion need settled, the land upon which the United States naval base at Guantanamo Bay must be returned, and there are other issues.

On Tuesday at the United Nations, the United States (joined by the State of Israel) again voted against a resolution which condemned "the embargo." The United States had sought to abstain, but the government of Cuba was unwilling to make changes to the resolution.

The "***goal posts***" are shifting…. Ironic that throughout decades the United States was accused of constantly adding terms to the list of requirements prior to the normalization of relations between the two countries. In some respects, the government of Cuba has placed an embargo upon the United States.

President Castro is unlikely to view as necessity the concept of quid pro quo as President Obama has little leverage.

The Obama Administration has voiced opposition to existing laws which form a basis for "***the embargo***"- CDA, Libertad Act and TSREEA. The Obama Administration removed Cuba from the Sanctions List. The Obama Administration re-established diplomatic relations, re-opened the

United States Embassy in Havana and permitted the government of Cuba to re-open an embassy in Washington, DC.

President Obama is unlikely to rescind existing OFAC and BIS regulations or return Cuba to the Sanctions List or close the respective embassies; and threats to go no further with expansive efforts are of little impact. The President wishes to visit Cuba in 2016. No secret. He may cancel a visit that was not requested.

While the Obama Administration may wish to **condition** a visit by the President to further changes in the commercial, economic and political landscape within Cuba, the government of Cuba recognizes that President Obama's desire to visit Havana is exponentially greater than the host country's believing that a visit is required to further its global interests- during and subsequent to President Obama's time in office.

The only materially impactful means for the United States to currently influence the bilateral timetable of the government of Cuba is to harness, corral, the governments of Argentina, Brazil, Canada, China, France, Germany, Iran, Russia, Spain, United Kingdom, Venezuela and Vietnam whose respective domestic considerations outweigh the value of constricting their mostly newly-energized commercial relationships (thus far more announcement than operational) with Cuba. That's not going to happen.

If President Obama is not prepared to arrive aboard Air Force One at Jose Marti International Airport in Havana and view a commercial, economic and political landscape unchanged or nominally changed with respect to his initiatives of December 2014 through September 2015, then he should not visit Cuba.

Irrespective of initiatives implemented by President Obama, the government of Cuba remains unlikely to permit a United States business presence as envisioned by President Obama.

Such would be disruptive, create unreasonable expectations amongst the citizens (both those residing in Cuba and those residing in the United States), be costly, and be unwelcome.

With **Venezuela's** increasing commercial and economic challenges, its financial support for the government of Cuba is lessening; and other countries are unlikely to replace the billions of United States Dollars flowing since 2000.

Thus, the government of Cuba is in a period of cautiousness and a full-on re-engagement with the United States is problematic as the policy of the United States remains to seek commercial, economic and political change within Cuba. Any re-engagement with the United States results in uncertainty… the government of Cuba dislikes uncertainty.

The government of Cuba neither trusts the intentions of United States companies nor the intentions of the United States government.

Regardless of the receptiveness by the government of Cuba, the Obama Administration has issued expansive regulations during the last eleven months; and plans to issue new regulations and to revise existing regulations in an ever-more expansive manner.

Will the OFAC license Maryland-based Marriott Corporation to manage a hotel located in Cuba? Probably in 2016. Will Illinois-based John Deere be permitted to export farm products to government of Cuba-operated entities rather than entities relatively independent of the government of Cuba? Probably in 2016. Would a renewable energy-related infrastructure

project be permitted? If it had a non-Cuba government component, perhaps benefiting a co-operative.

There may be an expansion of imports from the limited list within the new initiatives- if there are manageable political issues entangling the two countries.

Modest imports of specialty-market products including organic sugar, organic coffee, organic chocolate and confections, each of which might find venues such as ***Whole Foods Market or Trader Joe's***.

- Tobacco (cigars) and alcohol (rum).
- Nickel and cobalt imports will be debated.
- Healthcare research relationships will increase as will possible marketing opportunities for Cuba-produced healthcare products.

On September 18th 2015, President Obama's new and revised regulations from the OFAC and BIS resulted in: An evisceration of legislative efforts within the United States Congress; and a reallocation of funding resources away from Washington, DC-based advocacy organizations working in support of the legislative efforts

United States-based companies are viewing the "***end the embargo***" landscape during the remaining months of the Obama Administration as exclusively a focused exercise upon the issuance of new regulations and the revision of existing regulations.

There is <u>little value in funding legislative efforts</u> when there is unlikely to be legislation enacted into law before January 20th 2017. Some advocacy groups have begun tacking their focus (while blaming the Obama Administration) from the 114th United States Congress to the 115th United States Congress and to the next occupant of The White House; that's not going to work- too many unknowns and too few resources better directed elsewhere. Members of Congress may see their efforts to obtain contributions from United States-based companies lessen or evaporate.

There are unlikely to be statutory changes in United States law relating to Cuba until at minimum 2018, the retirement of President Castro as that moment fulfills a provision of the Libertad Act which conditions a government which does not include President Castro or former President Fidel Castro. This could change, but that would require the government of Cuba to not only authorize, but embrace initiatives offered by President Obama.

Another <u>intended or unintended consequence</u> of September 18th 2015, Members of Congress and advocacy groups have reversed their **2015 mantra** that the United States must do more to obtain more from the government of Cuba and have re-adopted the 2001 to 2014 perspective that the government of Cuba needs to change its policies and its laws and its regulations to authorize United States-based companies to commercially engage; and reverse the decline of food product and agricultural product cash-only imports permitted by the TSREEA- made more efficient through regulatory changes and revisions since December 2014.

On Tuesday at the United Nations in New York City, Minister Rodriguez said "***We should not confuse reality with wishful thinking or expressions of goodwill***,"… "***We can only judge based on facts***." Since December 2014, there has been "***no tangible, substantial modification***."

If the government of Cuba continues to respond in this way to each overture from the Obama Administration, the result will be a continued period of expectation, rather than implementation. ***Thank you.***