The Cuban Electric Company, 1922-1975: From Local to Global to Domestic

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Introduction

When Office Depot merged with OfficeMax in November 2013, the latter company brought an intriguing “asset” with it. The new company, which adopted the Office Depot name, now held the single largest claim against the government of Cuba for expropriations that occurred after Fidel Castro seized power. At $267,568,413.62 (plus 6% interest from August 1960—approximately $7.4 billion in 2017), this claim represents nearly three times the next largest claim and is 14% of all claims certified by the Foreign Claims Settlement Commission.1 OfficeMax had inherited the claim when Boise Cascade, a paper manufacturer and distributor of office products, purchased OfficeMax for $1.3 billion in 2003. The new company assumed the OfficeMax name.2 Boise Cascade had inherited the claim when it acquired Ebasco Industries for $560 million in 1969.3 Ebasco Industries traced its heritage to a name change after the merger in 1967 of two companies, previously parent and subsidiary, the Electric Bond and Share Co. (EB&S) and the American & Foreign Power Co. (A&FP). The Cuban Electric Company was a wholly-owned subsidiary of A&FP and was providing 90% of electric utility production in Cuba when it was nationalized in August 1960.4

The Obama administration’s move to normalize relations with Cuba in December 2014 raised the issue of these more than half-century old claims (and corresponding counter claims), and it is likely that they will be the subject of intense negotiations in the future.5 Our purpose here is to trace the historical antecedents of the largest claim by examining the history of the

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2 OfficeMax sold the paper, forest products, and timberland assets of the company in 2004 to a newly-formed limited partnership that retained the Boise Cascade name. It is now fundamentally a building products company. Mergent Industrial Manual, 2015, Vo. 1, New York: Mergent, 2015, 399.
Cuban Electric Company. We hope eventually to put the claim in perspective by comparing one dimension of the performance of the Cuban Electric Company relative to the performance of electric utilities in several Latin American and nearby Caribbean countries, as well as comparing it to the performance of Cuban Electric after nationalization.

**Early Electrification in Cuba**

Within a decade after Thomas Edison opened the Pearl Street station in New York (1882), domestic and foreign investors were establishing local electric utilities in Cuba. Many of these early stations were associated with existing railways, gas lighting companies, or urban tramways, enterprises that already had some access to capital. By the turn of the century, Havana, Cárdenas, Camagüey, Cienfuegos, Pinar del Rio, Santa Clara, and Santiago de Cuba had at least rudimentary electric service. These developments occurred despite disruptions caused by the Cuban War of Independence (1895-98) and Spanish-American War (April – August 1898). Following the U.S. victory and occupation, the Platt Amendment (1901) and Cuban-American Treaty of Relations (1903) recognized Cuban independence, reserved the right of the United States to guarantee that independence, and permitted the U.S. to oversee, and on occasion to interfere with, Cuban affairs. After these political events, and because of geographical proximity, business relations between Cuba and the United States grew increasingly closer. The United States became the major market for Cuban sugar, and Cuba became a major recipient of U.S. capital investment.

Foreign investment in Cuban electric companies increased in the first decade of the twentieth century, along with consolidations and frequent ownership changes. By 1925, total generating capacity of central station electric power in Cuba was 105,000 kilowatts. In addition, sugar refineries had installed over 15,000 kilowatts of generating capacity to power their operations as well as providing electric lighting to surrounding towns. By 1929, a subsidiary of

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7 On the difficulties faced during the war by the Spanish-American Light and Power Company, a U.S. company incorporated in 1883 with plants in Havana and Matanzas, see *New York Times*, Dec. 8, 1896.
the American & Foreign Power Company would control roughly 90% of central station capacity in Cuba and 75% of total generating capacity.\(^9\)

**The Rise of the American & Foreign Power Company**

A&FP was a subsidiary holding company of EB&S, a top-level U.S.-based holding company. Utility holding companies generated no electricity themselves; they held controlling interests in the operating companies that did generate electricity and in sub-holding companies. Holding companies earned revenue from dividends paid by their subsidiaries and from fees charged operating companies for finance, engineering, and managerial services.

The General Electric Co., an electrical equipment manufacturer, created EB&S in 1905 and gave it a portfolio of domestic and international stocks and bonds that General Electric had accepted in payment for electrical equipment. EB&S created five second-tier sub-holding companies over the course of the next two decades, including A&FP in 1923. The securities EB&S had received from General Electric were distributed to these companies in return for a controlling share of their stock. The sub-holding companies then acquired local utilities, consolidating them where possible, and modernizing them.\(^10\)

World War I was the catalyst for EB&S’s interest in purchasing and managing foreign electric utilities.\(^11\) The U.S. government was concerned about the war’s effects on the Panama Canal and suggested that EB&S purchase the electric utilities in Panama City and Colón, which was done in 1917. In 1920, utilities that had been seized from Germans by the Guatemalan government were acquired by EB&S. The first Cuban property, Cia. Electrica de Alumbrado y

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\(^10\) The sub-holding companies could issue bonds and non-voting preferred stock to raise capital, which then could be used to purchase sufficient shares of voting common stock in operating companies to gain control. Rates of return on the common stocks held by the promoters could be substantial. The Federal Trade Commission estimated rates of return in 1924 and 1925 ranging from 19% to 55%. United States Federal Trade Commission, *Control of Power Companies*, United States Senate, 69th Congress, 2nd session, Document No. 213, Washington: USGPO, 1927, xxiii-xxiv.

Traccion de Santiago, was acquired in 1922. By the end of the following year, EB&S owned electric utilities in Camagüey, Cienfuegos, Cárdenas and Santa Clara.\textsuperscript{12}

On December 18, 1923, EB&S announced the incorporation of the American & Foreign Power Company in Maine. The purpose of the new company was to “enter the public utility field of Cuba, Central America, and South America.”\textsuperscript{13} Total capital was to be a minimum of $50 million and EB&S intended to maintain a controlling interest in the company.\textsuperscript{14} Other securities were to be marketed to the public, including in New York, London, Paris, and Amsterdam.\textsuperscript{15} The next day, the \textit{New York Times} reported that subscriptions for the preferred stock had exceeded the amount available.\textsuperscript{16} E.B. Lee, a spokesperson for EB&S, exuded optimism over the new company. “The present is considered a most opportune time for the formation of an enterprise such as the American and Foreign Power Company, Inc., as many foreign exchanges are depreciated, making it possible for the new company, with its large available capital, to acquire properties at low price. It is understood that financial returns obtainable from public utility companies in foreign countries are much larger than in the United States. In fact, the Electric Bond and Share Company expects these foreign utility investments to yield an average return perhaps twice as much as is possible in this country.”\textsuperscript{17} While implicitly recognizing the possibility of exchange rate risk, Lee completely missed the possibility of political risk. Both of which would later bedevil the company.

\textbf{The American & Foreign Power Company Consolidates its Position in Cuba}

In 1924, its various Cuban properties contributed 74\% of A&FP’s total operating revenues. By late summer 1925, the company (along with EB&S) was purchasing shares on the open market, at a substantial premium, of the Havana Electric Railway, Light and Power

\textsuperscript{12} \textit{New York Times}, Dec. 5, 1923, 32.
\textsuperscript{14} This would fall between $700 million and $2.4 billion in 2016 dollars using either the consumer price index or labor value to adjust. Samuel H. Williamson, "Seven Ways to Compute the Relative Value of a U.S. Dollar Amount, 1774 to present," MeasuringWorth, 2017, \url{https://www.measuringworth.com/uscompare/index.php} (accessed July 21, 2017).
\textsuperscript{16} \textit{New York Times}, Dec. 20, 1923, 25. The 400,000 shares of preferred were priced at $96 a share, thus raising $38.4 million for the company. Each preferred share came with a share of the common stock. EB&S retained the rest of the common. Both classes of preferred stock carried a cumulative dividend of 7\%.
\textsuperscript{17} \textit{New York Times}, Dec. 19, 1923, 29.
Company, whose capitalization at the time exceeded that of A&FP.\(^{18}\) In December 1925, A&FP took control of the Havana utility.\(^ {19}\) EB&S transferred its shares in the Havana electricity plants to A&FP, giving A&FP control over nearly all central station utilities in Cuba.\(^ {20}\) By the end of 1927, A&FP also controlled local electric utilities in Panama, Guatemala, Ecuador, Colombia, Brazil, and Venezuela. Its consolidated assets totaled $379 million.\(^ {21}\)

A&FP continued to expand its holdings in 1928, adding fourteen utilities, mostly in South America, in the third quarter alone, increasing its total assets to $543 million. In May 1928, all Cuban holdings were consolidated into one operating company, Compañía Cubana de Electricidad (Cuban Electric Company). A&FP stated in its 1928 annual report that this “simplified and improved operating conditions by eliminating many small companies with the expense incident to maintaining them. It has improved the service and the power generation efficiency and has enabled the operating company to reduce rates. It has simplified and strengthened the capital structure.”\(^ {22}\) The Cuban subsidiary contributed 57% of the gross revenue of A&FP in 1928, more than twice the next largest contributor, its Brazilian subsidiaries.\(^ {23}\) In 1929, after acquisition of properties elsewhere (Chile, Mexico, and Shanghai, China), the Cuban subsidiary’s contribution to A&FP’s total revenue fell to 29%, still more than subsidiaries in any other country. A&FP claimed over $750 million in assets on its consolidated balance sheet for 1929.\(^ {24}\)

Then the emerging world-wide Depression began to adversely affect A&FP. Gross revenues of the Cuban Electric Company declined by 1% in 1930, while net revenues rose slightly. Because of exchange rate depreciation in several countries, overall gross dollar revenue

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19 The takeover was effected by creation of a new company, the Havana Electric and Utilities Company. The president of Havana Electric Railway, Light and Power Company, Frank Steinhart, was allowed to remain as president of the new company. *New York Times*, Dec. 19, 1925, 30.
20 In 1926, the street railway properties were split, with A&FP retaining ownership of the electric plants but not the railways themselves. *New York Times*, Aug. 12, 1926, 25; Aug. 15, 1926, E10; Oct. 30, 1926, 29; Nov. 26, 1927, 19; Jan. 19, 1928, 47.
23 *New York Times*, Mar. 15, 1929, 40; June 11, 1929, 44.

EB&S maintained a special relationship with A&FP. It was the only sub-holding company in the system in which EB&S had retained majority ownership. In March 1929, EB&S reorganized, creating a new company with the same name. In the process, EB&S increased its investment account instantaneously by $400 million, all of which was attributed to an increase in the “market value” of A&FP. U.S. Federal Trade Commission, *Utility Corporations*, U. S. Senate, 70th Congress, 1st session, Document 92, parts 23 and 24, Washington: USGPO, 1930, 410.
of A&FP was down about 3% over the course of the year. The company, nevertheless, continued to acquire properties in 1930, including several small ones in Cuba and several in India. Total assets of the company grew to $987 million.25

The years immediately following would prove to be very difficult for Cuban Electric and its parent, A&FP. In 1931, total assets of A&FP reached almost $1 billion but then fell to roughly $750 million in 1932, where they stabilized for the rest of the decade.26 Operating revenues fell by roughly 18% in dollar terms for both Cuban Electric and A&FP overall. The Depression hit Cuba very hard. Between 1929 and 1933 exports fell by 70% and imports by 80%. Between 1928 and 1933, net national product in current prices fell by 26%.27 These economic difficulties generated considerable political and labor unrest.

A&FP had a very close relationship with the leader of Cuba at the time, General Gerardo Machado, and the Cuban Electric Company was considered by many to be almost part of the government of Cuba, even though it was foreign owned. One of the properties EB&S acquired in 1923 was previously owned by Machado, who had risen to prominence in the Cuban War of Independence. He became mayor of Santa Clara and owned the Compañía Cubana de Electricidad in that city. When EB&S bought the company in 1923, Machado retained the title of vice-president. A&FP supported Machado and invested $500,000 in his successful campaign for president in 1924. Machado generally favored foreign investment and suppression of labor unions, and clearly looked after the company’s interests. The company’s close ties to Machado, however, may have contributed to consumer and labor unrest. There were periodic local boycotts, and municipalities passed numerous resolutions demanding lower lighting rates. Machado vetoed forty-six of these municipal resolutions during his term.28

Troubles, both in Cuba and for A&FP, escalated during 1931-34. In the summer and fall of 1931 there was a nationwide campaign in Cuba against high electric rates, including demands that the company lower average rates from 16 cents to 10 cents per kilowatt hour, that it reduce

25 American & Foreign Power Company Inc., Annual Report, 1930. The Cuban peso was pegged to the U.S. dollar at parity. The company also raised $50 million by selling gold debentures to a bank syndicate and sold a $20 million debenture of the Cuban Electric Company to its parent company, EB&S.
26 Consolidated assets in nominal dollars did not approach $1 billion again until 1954. American & Foreign Power Co., Annual Reports.
the minimum flat rate, and that it reduce industrial rates proportionally. Numerous mass meetings were held, boycotts threatened and initiated, and one municipality proposed converting the local electric plant into a cooperative. At the protest’s peak, the company may have lost as many as 40,000 customers due to boycotts. As noted above, operating revenues in Cuba fell by 18% in 1931, but there was otherwise no mention of the Cuban protests in the company’s annual report, and it appeared to be weathering the storm.

The boycott of 1931 gradually subsided, and 1932 was relatively quiet, at least in Cuba. Operating revenues of the Cuban subsidiary, however, fell by another 21% in 1932, and A&FP was forced to suspend dividend payments on its preferred stock. The price of sugar was 59% lower in 1932 than it had been in 1929, putting tremendous strain on the nation’s sugar industry and its workers.

By the beginning of 1933, “As the national economy disintegrated, Cuban society rapidly advanced into a state of undeclared civil war.” In March 1933, a bomb exploded at the Cuban Electric Company’s headquarters in Cienfuegos. No casualties were reported, but it did considerable damage. Patrolmen in different parts of that city and in Havana reportedly came under fire. Organized labor was active in protests. In July, bus drivers went on strike. Soldiers fired on demonstrators in Havana on August 1, killing several people. Across the country, more workers joined the strike, including tobacco workers and journalists in Pinar del Rio, and typographers, journalists, and dock workers in Havana. The military took control of Havana on August 9 and Machado resigned on August 11 and fled the country. By the end of the year, several American-owned sugar mills announced that they were suspending operations due to unreasonable union demands. The Wall Street Journal reported that there had been little damage to the properties of the Cuban Electric Company, and that it was one of the few

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32 It had never paid dividends on its common stock.
organizations whose employees did not join the strike. However, the company had suffered a loss of revenue due to “the revolution.”\textsuperscript{38}

After a brief period of collective leadership, Ramón Grau San Martín was named President of Cuba. Protests and boycotts against the power company continued. With the agreement of A&FP, a commission to study the rate issue was created. It recommended rate cuts averaging 25%. On Dec. 7, 1933, President Grau issued a decree ordering the company to reduce its electric and gas rates by 45% across the country without reducing wages or reducing personnel. The company protested vehemently. Other American-owned firms also faced demands to lower rates. The Cuban Telephone Company, a subsidiary of the International Telephone and Telegraph Company, was ordered to reduce rates for personal and business lines by 40% and 44%, respectively.\textsuperscript{39}

On December 16, 1933, employees and managers of the Cuban Electric Company announced that a strike scheduled to have begun that day would be postponed for thirty days. The company had agreed to thirty of forty-one demands, including those for a 48-hour work week and fifteen days of paid vacation, but wanted more time to consider the remaining demands. The company also announced that it was appealing the 45% rate reduction to the Supreme Court.\textsuperscript{40} The company failed to accept enough of the employee’s demands, and negotiations broke down. The strike was to begin on January 14, 1934. The secretary of the Light and Power Workers’ Union announced that “It will be a strike of blood and fire.”\textsuperscript{41} There were reports of physical intimidation and violence against more moderate employees of the company, and the company’s attorney had been beaten by employees in the main office building.\textsuperscript{42} When the strike indeed began, the Cuban government seized control of the company, and service was reduced but not entirely suspended. The President of the Cuban Electric Company, S. J. Mahoney, immediately protested to the U.S. State Department. The seizure was not considered

\textsuperscript{38} \textit{Wall Street Journal}, August 15, 1933, 9.
\textsuperscript{40} \textit{New York Times}, Dec. 16, 1933, 11; \textit{Washington Post}, Dec. 16, 1933, 2. The articles also noted that a demonstration of 35,000 people had been held in Havana that day to express gratitude to the Grau administration for a recent decree mandating use of at least 50% Cuban labor in foreign-owned firms.
\textsuperscript{42} Ibid.
to be permanent by President Roosevelt’s personal envoy in Havana, rather it was thought to be a “provisional intervention.” Union members were put in day-to-day control of the company.

At the same time the government assumed control of the electric company, army Sergeant Fulgencio Batista led a successful coup. Carlos Mendieta, a revolutionary war veteran and opponent of Machado, was made President of Cuba. On January 20, it was announced that employees and officials of the Cuban Electric Company were trying to settle the labor dispute. Several days later, Pres. Mendieta formed a commission to study the problems raised by the recent strike and the decree mandating the 45% rate reduction. Jesus Correro, Luis Machado, a cousin of former President Machado, and Eduardo Chibas, Sr. were appointed to the commission. Within days, managerial control was returned to the company. Electricity, gas, water, and streetcar service workers across the country immediately commenced a strike. Military guards were placed at power plants and main offices of Cuban Electric. It was reported that the company had accepted all of the long-standing demands of the union, but employees had balked at replacement of the general manager. President Mendieta issued a stern proclamation asking for cooperation “to free Cuba from a state of chaos and ruin.” Simultaneously, the government suspended all authorizations for public demonstrations. American officials were reportedly pleased by the actions of the Mendieta government, but tobacco workers and bus drivers remained on strike, and student protests were ongoing. Chaos continued with intermittent bombings and shootings. Electric power was only partially restored, and the former general manager of the company, and strike leaders, were placed under arrest. The labor dispute finally ended in May when the company capitulated to most of the union demands.

45 Batista became Army Chief of Staff, which gave him control of the Cuban Army.
50 In response to the U.S.-friendly coup, Franklin D. Roosevelt on March 9, 1934, issued an executive order creating the Second Export-Import Bank of Washington (the first bank having never made any loans). Its initial purpose was to facilitate trade with Cuba. The first loan made by the bank was to finance Cuba’s purchase of silver ingots from the U.S. This may have been to bolster the value of the Cuban peso, which was linked one-to-one to the dollar. The two banks were later merged into the Export-Import Bank. http://www.exim.gov/about/history-exim/historical-timeline/legislative-history, accessed June 21, 2017.
52 Wall Street Journal, June 1, 1934, 9.
Another general strike occurred in 1935. It was begun by high school students and teachers, spread to University of Havana students and faculty, and then was joined by labor unions. This strike was brutally repressed. The university was closed (for three years) and many leaders of the strike were assassinated or abducted and executed. The reaction to this repression was so intense that Carlos Mendieta faced dissent within his government, eventually lost support, including Batista’s, and was forced to resign in December. Batista remained the power behind a series of puppet Presidents until he assumed the office himself in 1940.53

In its 1933 annual report, A&FP for the first time acknowledged the difficulties of its Cuban subsidiary, lamenting the decline in revenues (total revenues by 12.4% and net revenues by 27%), the rate reduction decree, the strike, the temporary government takeover, and the difficulties the government and municipalities were having in paying their bills. Nonetheless, the company remained hopeful for the future, praising the reduction in the tariff on Cuban sugar of 25% and the establishment of a quota for Cuban sugar imports into the United States.54

Operating revenues of the Cuban Electric Company continued to decline in 1934, finally reaching a trough. They were 18% lower in 1934 than they had been in 1933. Overall, operating revenues declined by 52% from 1929 to 1934.55

The Cuban economy began to improve slowly after 1934. Net national product rose by 23% from 1933 to 1940.56 Gross operating revenues of the Cuban Electric Company rose from $10.6 million to $12.0 million over the same period, a 13% increase. In 1940, the Cuban subsidiary contributed 20% of the operating income of A&FP, still more than its subsidiaries in any other country.57

Aftermath of the Crash and Depression: Company Reorganizations

Holding companies had long been accused by progressives of using their excessive power to victimize both utility customers and outside investors. The Depression brought the collapse of several prominent utility holding companies, and most of those that survived suspended dividend

56 Net national product figures for Cuba were not available for 1934. Mitchell, Historical Statistics, 750.
57 American & Foreign Power Co., Annual Reports, 1933-1940.
payments. With Franklin D. Roosevelt’s New Deal, the critics of holding companies came into power, and they acted swiftly and punitively. The Public Utility Holding Company Act of 1935 (PUHCA) contained a “death sentence” that mandated the dissolution, within three years, of most holding company systems in the U.S. The newly-formed Securities and Exchange Commission (SEC) was made responsible for enforcement of PUHCA. All holding companies not exempted had to register with the SEC. Despite the three-year mandate, full implementation took decades because of litigation initiated by the companies, and the law’s complex requirements.

A&FP (but not its parent, EB&S) was granted an exemption from most (but not all) of the law’s severe requirements because none of its subsidiaries operated in the U.S. Although EB&S remained the largest shareholder of A&FP, the two companies had no officers, directors, or employees in common. In December 1939, A&FP resumed paying dividends. In January 1943, the international division of Ebasco Services, then a subsidiary of EB&S, was transferred to Ebasco International, a subsidiary of A&FP.

Eventually, EB&S divested all its subsidiaries, retaining only its service company, Ebasco Services, Inc. and a controlling interest in A&FP. A&FP was required by the SEC to simplify its financial structure, which then consisted of debentures, serial notes, bank notes, three classes of preferred stock with dividend arrearages of $410 million, common stock, and option warrants. Difficulty obtaining financing delayed A&FP’s financial simplification until 1949, when EB&S transferred debt it held of Cuban Electric to A&FP and restructured AF&P’s debt to the parent company. A&FP was then able to obtain bank financing and reorganized its financial structure in February 1952.

58 The collapse of Samuel Insull’s Chicago-based empire was probably the best known and most widely publicized. Electric Bond & Share survived the crash but was weakened substantially.
Progress and Setbacks in the 1950s

From 1940 to 1952, the operating revenues of the Cuban Electric Co. rose sharply from $12 million to $47.3 million. In 1952, Cuban Electric contributed 25% of the total operating revenues of A&FP, which had risen from $61.4 million to $187.2 million. Total assets on the consolidated balance sheet of A&FP rose from $755 million to $914 million. In its 1952 annual report, A&FP announced a planned increase in generating capacity in Cuba of 45%, later raised to 63%, by the end of 1955. In addition to two $12 million loans from the Export-Import Bank, the company was successful raising funds in Cuba through a consortium of local banks and security sales to the public, about which it was very proud. While frequently expressing concern about the heavy reliance on sugar exports, A&FP felt that the Cuban economy had untapped potential. Consolidated operating revenues of A&FP in the 1950s remained flat, fluctuating around $200 million per year, while consolidated assets of the company rose from $954 million in 1953 to $1.2 billion in 1959. Cuban Electric raised annual the dividends paid to A&FP during the 1950s from $.50 per share in 1952 to $1.50 per share in 1956-58. In addition, there were stock dividends in 1953 and 1954. A&FP owned 88% of the outstanding shares of common stock. A&FP’s annual reports exuded optimism during this period, but there remained periodic unrest in Cuba, unacknowledged publicly by the company, and the situation changed dramatically by the end of the decade.

63 Adjusting for changes in the U.S. consumer price index, operating revenues slightly more than doubled (a 108% increase). Williamson, MeasuringWorth.
64 In 1951, the International Bank for Reconstruction and Development (World Bank), in collaboration with the government of Cuba, issued a report by a technical and economic mission that had been conducted in 1950. The report noted the relatively high rates for industrial electric power. For non-industrial uses, the report cited the fact that the system owned by the Cuban Electric Co. was operating close to capacity with outdated and inefficient equipment, that expansion was necessary, and that “the true financial position of the Company is hard to assess” (p. 325). The report went on to state that “By standards of other countries, however, rates are high and, as already noted, some big industrial consumers who could buy the Company’s power are finding it cheaper to generate their own. There are widespread public complaints, too, about the cost of electric power” (p. 326). The report suggested that Cuban Electric focus on expansion of non-industrial power. International Bank for Reconstruction and Development, “Report on Cuba,” Washington, D.C., 1951, 170, 323-27.
65 In 1957 Cuban Electric held a bond sales contest for employees. The grand prize was an 18-day trip for two to Europe, which was won by César Rodríguez, who sold $112,500 in first mortgage bonds (roughly $1 million in 2019 dollars). Nine other employees won trips to Washington, New York, Mexico City, and Miami. American & Foreign Power Panorama, by the company, September 1957.
66 A&FP eventually was compensated for the expropriation of most of its Argentine properties, but the proceeds had to be invested in Argentina. American & Foreign Power Company, Annual Reports, 1952-1959.
Fidel Castro and the Expropriation of the Cuban Electric Company

After a lengthy, sporadic revolutionary campaign, Fidel Castro took control of the Cuban government on January 1, 1959. The full implications for foreign investors were not immediately clear. Castro clearly had been advocating radical reforms, but opposition to the Batista regime seemed central to his concerns. Some accounts held that after ousting Batista, Castro intended to rule for several years and then hold free elections. Once taking over, however, Castro acted quickly to consolidate his power, including naming himself Prime Minister in February. It became clear that there would be no elections.

One of Castro’s spokespersons in the U.S., Constantine Kangles, U.S. general counsel for the Republic of Cuba, reassured American investors by maintaining that Castro would use U.S. programs, such as the New Deal and Fair Deal, as templates, and was primarily concerned with improving life in rural villages. He asserted that “the Cuban regime has no intention of nationalizing property, foreign or domestic.” Kangles cited Manuel Urrutia, Castro’s choice for Provisional President, as the source of these positive statements. Other news from the new regime was not so reassuring. The New York Times reported that there had been “widespread reports” that Castro favored nationalization of all utilities, including the properties of A&FP and International Telephone and Telegraph (IT&T). In late February, the government announced the creation of a commission to investigate the operations and rates of both Cuban Telephone (an IT&T subsidiary) and Cuban Electric. The commission was headed by the Minister of

69 Several early accounts in the New York Times were optimistic, noting that the end of the revolution “would bring an improvement in economic and business conditions.” Grant Hylander, an A&FP vice president, noted that there had been no major damage to electrical properties and that “he did not expect the property to be nationalized.” New York Times, Jan. 3, 1959, 3.
Communications, Enrique Oltuski, an American-trained engineer. Oltuski asserted that the study
would be thorough and that he expected to be able to lower rates, but that there would be no
government intervention in the operation of the companies.73

The commission released its report on Cuban Electric in late June, but A&FP claimed not
to have been given a copy until August, after a rate reduction already had been ordered.74 The
report criticized the company for its perceived inefficiencies and was particularly harsh regarding
what it claimed were its “excess profits” and “overvaluation” of assets. It noted the critical
importance of access to electricity as a component of modern life and asserted that strict
regulation or state ownership was necessary in order to reduce inefficiencies.75 The Agrarian
Reform Law of May 17, 1959 had shocked the sugar interests (with its prohibition of foreign
ownership) and ranchers (with its dismantling of large land holdings), but mining, petroleum,
hotel, and utility interests “seemed a little bit more hopeful than they did even a few months
ago.” The regime was perceived to be more honest than previous ones, and “economists…feel
that Dr. Castro is slowly learning that, if he is to succeed, he must be much more considerate of
foreign investors, particularly Americans.”76 That was the last positive bit of news the owners of
the Cuban Electric Co. received.

On August 20, 1959 Cuban Electric was ordered to cut its basic rate from 9 cents to 6
cents per kilowatt-hour, and its overall rates by 30.5%, retroactive to Aug. 1. Castro and his
cabinet cited the commission report, highlighting excessive engineering service fees, excessive
fuel costs, and inadequate administrative procedures. The company also was ordered to continue
its expansion program.77 The President of A&FP, Henry Sargent, immediately returned to New
York from Argentina, where Argentine properties taken over by the government were being

73 New York Times, Feb. 24, 1959, 12; The Militant, March 2, 1959, 1. Two investigators from the Commission, both
engineers, visited Cuban Electric managers in April, requesting detailed information on rates and kilowatt-hour
sales. The company’s response was determined to be inadequate. “Relations with Rate Investigating Committee,”
typescript, April 29, 1959 (from the files of John Plunket, who was President of Cuban Electric when it was
nationalized; files provided by Paul Plunket, John Plunket’s nephew).
University, 1982, 8-9. The company had been subject to a maximum rate of 9.3 cents per kilowatt-hour for the first
100 kilowatts of use since 1933, but by the 1950s this would have been non-binding. Tremayne, “Cuban Electric,”
12.
from the University of Havana in 1950.
indicated that the overall rate reduction amounted to 22%.
appraised, to discuss the situation.\textsuperscript{78} The timing of the announcement was unfortunate for the company. It occurred a day after an issue of $15 million of A&FP 6\% convertible debentures due in 1984 had been oversubscribed in the bond market but not yet delivered by a consortium of investment banks led by First Boston. The price of A&FP’s stock immediately fell 17\% to a level 25\% below the exercise price provided by the debentures, sharply reducing their value to investors. The next day, “in a financial move without parallel in recent memory,” the issue (which came to be known as the “Castro convertibles”) was cancelled. Henry Sargent vowed to go to Cuba to discuss the situation, hoping to bring back the bond issue in the near future.\textsuperscript{79} This never happened.

In September, Roberto Acosta, head of the government’s rate investigation commission, asserted that the government had no intention of “confiscating or destroying” the Cuban Electric Company, wishing only to regulate it. The commission recommended reducing the book value of the “inflated assets” of the company from $292 million (as of Dec. 1958) by $86 million. An additional $46 million of “accumulated reserves” was also removed from the value of assets, leaving a figure of $160 million, on which the company was to be allowed a 7\% return, which would sharply reduce revenue. The company strenuously objected to the reductions and requested that it be allowed to send “a group of experts to work with the investigating committee.” Acosta welcomed the idea and stated that “we are willing to reconsider our decision if the company can prove to us that we are wrong.”\textsuperscript{80} In October, Communications Minister Oltuski reiterated that the company had not yet demonstrated a sufficient reason to justify suspension of the decree reducing rates but claimed that he remained ready to discuss the matter further.\textsuperscript{81} Nothing came from this. In November, A&FP cut its dividend by half, to 12.5 cents per share and opened negotiations for a $10 million loan from the Cuban government. The loan was to partially replace the $15 million bond issue that had been cancelled when the rate reduction was announced. It was to be used for expansion of the electrical system in Cuba. Cuban Electric

\textsuperscript{78} \textit{New York Times}, Aug. 26, 1959, 47.
\textsuperscript{80} \textit{New York Times}, Sept. 12, 1959, 25. The A&FP Annual Report, 1958 (p. 28), states that the capitalization of the Cuban subsidiary was $272 million in 1958. The 1960 Annual Report (p. 7) noted that when Cuban Electric was expropriated, there were approximately $280 million in outstanding securities.
executives remained “optimistic about prospects for negotiating a revision of the rate cuts.” They had submitted a 108-page answer to the order cutting rates and felt that they had “a good case.”

Cuban Electric had stopped making dividend payments, most of which went to A&FP, in September 1959. The company defaulted on an $8 million bank loan due in November, and suspended payments on its Export-Import Bank construction loan. In March 1960, A&FP announced that its net earnings for 1959 had declined by 31%, due mostly to the reduction of electricity rates in Cuba. Negotiations between A&FP and the government regarding rates had reached an impasse by early 1960 and it was clear that A&FP was preparing for a potentially more disturbing intervention.

Relations between the U.S. and Cuba deteriorated through the first half of 1960, as Cuba moved closer politically to the Soviet Union and the U.S. responded. On July 6, 1960, Cuba passed Law No. 851 (the Nationalization Law), a direct response to President Eisenhower’s decision to cut Cuba’s 1960 sugar quota, essentially completely shutting off the U.S. market for the rest of the year, leaving Cuba with huge inventory of unsold sugar that had little prospect of being purchased by other countries. This law set up the legal means for the seizure of American-owned properties. On August 6, 1960, Cuba nationalized the Cuban Electric Company, the Cuban Telephone Company, three American-owned oil refineries, and thirty-six American-owned sugar mills “in retaliation for the ‘economic aggression’ of the United States.” The properties were immediately seized by the military and civilian militia. Relations continued to deteriorate. A U.S. embargo on shipments of material to Cuba in October 1960 led to the nationalization of remaining American-owned businesses in Cuba.

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83 American & Foreign Power, Annual Report, 1959, 32.
84 Tremayne, “Cuban Electric,” 30-32.
87 New York Times, Aug. 8, 1960, 1. Compensation was set according to the Nationalization Law.
The Aftermath of Nationalization

In its 1960 Annual Report, A&FP acknowledged the loss of its Cuban properties, for which it was not expecting to be compensated. It stated that the amount of securities of Cuban Electric outstanding was approximately $280 million, 72% of which were held by U.S. interests: 60% by A&FP and 12% by the Export-Import Bank, other U.S. banks, and mutual investment funds. In January 1961, two New York banks charged off loans they had made to Cuban Electric: Manufacturers Trust for $1.5 million and Irving Trust for $750,000.

In 1962, the U.S. Internal Revenue Service (IRS) ruled that U.S. citizens and corporations could claim tax deductions for certain losses of property seized in Cuba. The Commerce Department had estimated total losses to have a book value of roughly $1 billion. The Cuban government’s compensation offers were recognized as completely unrealistic. A&FP wrote off its entire investment in Cuban Electric (listed for tax purposes as $168 million) in 1960, which wiped out the company’s tax liabilities for the next half decade. The IRS cautioned, however, that should any of these losses eventually be recovered, such compensation would be considered taxable income when received.

A&FP (and its parent EB&S) would struggle after the loss of its largest property and gradually withdraw from the business of operating foreign electric utilities. In its 1961 Annual Report, the company noted that it was by then receiving over one-third of its income from a diversified portfolio of non-utility direct investments and foreign government bonds and that it intended to increase this percentage. The SEC had recognized the changing nature of the

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89 Several years later, in 1962, the executives of Cuban Electric discussed, and received a legal opinion on, the hypothetical possibility that the properties would be returned by the Provisional Government, a notion they rejected. John Plunket, President of Cuban Electric, argued that they “should give no consideration to accepting the return of the properties,” which “were taken under a law and a procedure which were perfectly valid under the Constitution in effect at the time. The only thing left to discuss is the compensation for the taking.” “Memorandum to Mr. D. G. Lewis,” Nov. 23, 1962 (John Plunket file). A legal opinion provided in December argued that the seizure was, under U.S. and international law, illegal without just compensation. Reid & Priest, “Memorandum,” Dec. 26, 1962 (John Plunket file).


92 The FCSC later raised this figure to $1.9 billion. See “Introduction” above.


94 In addition to the confiscation of its Cuban properties, in 1959 A&FP had been forced to sell its Mexican properties to the government. It already had lost its Argentine properties. American & Foreign Power Co., Annual Report, 1959.
company by exempting EB&S from PUHCA in August 1960.\textsuperscript{95} A&FP, still a subsidiary of EB&S, became a registered investment company in February 1961 and continued to shed, or be shorn of, its utility properties. As noted above, EB&S and A&FP merged in April 1967, adopting the name Ebasco Industries, which then merged with Boise Cascade in 1969.\textsuperscript{96} Ebasco Industries at this time was described as “a closed-end investment company with subsidiaries engaged in engineering design, construction, and consultation in the utility, chemical and construction fields throughout the world.”\textsuperscript{97} There was no mention of foreign utilities, but the company still owned several South American utilities and other properties and investments it had purchased with compensation it received for other expropriations in South American countries. In 1973, Boise Cascade sold Ebasco Services, the engineering division of Ebasco Industries, to Halliburton.\textsuperscript{98} By 1976, Boise Cascade had shed all of its Latin American investments not related to forest products, leaving the Cuba claim as the only remaining asset from its merger with Ebasco Industries.\textsuperscript{99} This is the claim that passed through OfficeMax to Office Depot.

**Claims under the Foreign Claims Settlement Act**

In 1964, “the U.S. Congress directed the Foreign Claims Settlement Commission … to determine the validity and amount of claims of U.S. nationals against Cuba based on losses resulting from the nationalization, expropriation, intervention, or other taking of properties between January 1, 1959 (the triumph of the Cuban revolution) and October 16, 1964 (the date of the program’s authorization).”\textsuperscript{100} The Cuban Electric Company clearly was covered by this

\textsuperscript{95} U.S. Securities and Exchange Commission, 27\textsuperscript{th} Annual Report, fiscal year ended June 30, 1961, 87\textsuperscript{th} Congress, 2ns Session, House Document No. 269 (Washington: USGPO, 1962), 100-01.


\textsuperscript{97} Wall Street Journal, July 24, 1969, 13.

\textsuperscript{98} After the U.S. Justice Department filed an antitrust suit, Halliburton sold the division to Enserch (previously Lone Star Gas) in 1976. Raytheon then purchased the division in 1993. From there the company begins to fade into obscurity. It was mentioned as a “legacy” company of Washington Group International in an article on the World Trade Center terrorist attack, in which the company lost 18 employees. Washington Group was later purchased by URS Corp, itself purchased in 2014 by AECOM, a Fortune 500 company. Ebasco Services, however, is no longer specifically identified as a subsidiary on the company’s web page; http://siteselection.com/ssinsider/special/sp010917b.ed3.htm; https://en.wikipedia.org/wiki/URS_Corporation; https://en.wikipedia.org/wiki/AECOM (accessed July 5, 2017).


action and a claim was duly filed. In addition, Ebasco Industries filed a separate claim (later assigned to Boise Cascade).

Ebasco’s claim on behalf of A&FP against the Cuban government included the value of land ($114,000), mortgage bonds issued by the Cuban Electric Co. ($11.3 million, plus interest), and contractual rights to receive bonds to be issued by Cuban Electric to replace collateral ($29.9 million), for a total claim of $42.7 million. The Commission found the claims for land and the mortgage bonds to be valid, but denied the claims for the contractual rights to receive bonds in the future. The total certified claim was $11.75 million.

The original claim on behalf of the Cuban Electric Co. was for $323.6 million. It included the loss of utility plants ($285.3 million), other current assets ($30.2 million), other investments, losses on equipment sales, liability to suppliers, deferred debits, retirement plan funding, resettlement of employees, and preservation of assets (which together summed to $8.1 million). The Commission agreed on the value of the utility plants, but denied many of the other claims, including that for stocks or bonds in tennis, country, and yacht clubs, and most claims relating to employee resettlement and retirement funding. The total loss was set at $319.4 million, from which was deducted debts owed to agencies of the government of Cuba ($41.1 million, including that owed to the Cuban bank, Financiera Nacional de Cuba). The Commission also deducted the $11.75 million already certified as a loss to Ebasco, making the total certified loss $266.5 million. Boise Cascade’s lawyer filed an objection to most of the denied claims. A hearing was held in June 1970 and a final decision was issued on August 19, 1970. The Commission again denied most of the claims, but added $1.05 million to the original claim, making the final certified loss $267.6 million.

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103 The decision was issued on Sept. 11, 1969. The Commission held that the holder of the collateral for the bonds, the Export-Import Bank, would be the proper claimant, but that as an agency of the U.S. government the Bank was not eligible to make a claim under the Act. FCSC, Decision No. CU-3866, 6.
104 FCSC, Claim No. 2578. From Aug. 6, 1960 until the time of settlement of the claim, 6% annual interest was to be added to the claim. No funds have yet been paid out. Boise Cascade also inherited from Ebasco the largest claim in the China Claims Program due to the loss of A&FP’s Shanghai Power Co. Its certified claim was $54 million. The China Program was completed when China agreed to a payment of $80.5 million to the U.S. government (roughly the amount of Chinese assets frozen in the U.S.). There were 381 certified claims totaling $197 million. Payments amounted to $1,000 plus 39.03% of the claim. It does not appear that interest was paid. This forced Boise Cascade to initiate a campaign to find private Shanghai residents who owned shares of the company in 1949. New York Times, Jan. 28, 1979, A22; Fox Butterfield, “Boise Seeks Lost Shareholders,” New York Times, Dec. 26, 1979, D1;
Assessing the Impact of American and Foreign Power and Nationalization of the Cuban Electric Company

While it is impossible to know what the trajectory of Cuban electrification would have been without the existence of A&FP (a classic counterfactual), we can at least put in context electricity production compared to several other Latin American and Caribbean countries and, more importantly, assess the growth of electricity production before and after nationalization. Figures 1 and 2 show total utility electricity generation in Cuba and the annual growth rate of electricity generation. While Figure 1 looks fairly steady, except for an apparent blip in the late 1950s, the growth rate figure identifies three distinct periods: rapid growth in the early 1930s, shortly after A&FP obtained control of the vast majority of electricity production in Cuba and until the effects of the depression were felt, and two later and distinctive spurts, at the end of World War II and in the late 1950s. Figures 3 and 4 put electricity production in Cuba in some perspective by comparing it to production in four other countries from the late 1920s to 1965 and to six other countries from the early 1960s to 1988. Cuba does not appear to be distinctive either before or after nationalization. Figure 5 uses recent (2012-15) production and installed capacity data to calculate utilization rates, or how efficiently, on an average daily basis, the electric utility sector is using its installed capacity. Cuba is at the lower end of this scale.

We then performed a standard econometric analysis of the time series data for Cuban electric utility generation, looking for statistically significant breaks in the growth rate of electricity generation.

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105 Industrial generation is excluded.

106 The electric utility in Uruguay was government owned throughout. The utility in Paraguay was taken over by the government in 1948, that in the Dominican Republic in 1955, that in Guyana in the 1960s, and that in Jamaica in 1974. Prior to the takeovers, utilities in these countries mostly were foreign owned. The utility in Barbados was foreign owned throughout. William J. Hausman, Peter Hertner, and Mira Wilkins, Global Electrification: Multinational Enterprise and International Finance in the History of Light and Power, 1878-2007, New York: Cambridge University Press, 2008, pp32-33, Appendix B.

107 Paraguay stands out as being particularly efficient, but it is unique in that it exports nearly 75% of it its production, which is entirely hydroelectric. 2015 Energy Statistics Yearbook, Tables 30, 33.
production. Table 1 presents summary statistics for the growth rate of electricity generation in Cuba by decade between 1931 and 1975. Electricity production by public utilities in Cuba grew by an average of 8.1 percent per year between 1931 and 1975. The greatest growth in electricity production in Cuba occurred in the 1950s, during which decade A&FP was enhancing its investment in Cuba. Electricity production grew at an average annual rate of 12.1 percent per year in the 1950s. The largest single year of growth in electricity production, surprisingly, was the revolutionary year 1959, during which time electricity generation grew by 41.7 percent. In contrast, growth in electricity production slowed substantially during the 1960s, growing at an average rate of 5.1 percent per year. Growth in electricity production picked up briefly in the 1970s but did not reach the levels observed during the 1940s and 1950s. Based on a series of statistical tests, we conclude that the nationalization of the Cuban Electric Company in August of 1960 coincided with a marked, statistically significant decline in the growth rate of electricity production in Cuba. This conclusion, of course, does not relate in any way to the question of the validity of the value placed on the nationalized assets by the Foreign Claims Settlement Commission. It does suggest that being a member of the American & Foreign Power Company system added value to the Cuban Electric Company, at least relative to the nationalized firm.

Conclusion

The electrification of Cuba was in many ways typical of the process in less developed countries around the world, particularly in Latin America and the Caribbean. Towns initially were electrified by companies established by local capitalists, often with the substantial support of foreign direct investors, especially from the United States and Canada. During the late 1920s, the heyday of the world-wide utility holding company movement, the Cuban properties were consolidated into a single company, Compañía Cubana de Electricidad (Cuban Electric Company), by the globally expanding American & Foreign Power Company (A&FP). In 1930 the Cuban Electric Company contributed more revenue to A&FP than utilities in all other

108 The unit root test results indicate that electricity generation in Cuba was an I(1) process, meaning that the growth rate of electricity generation was stationary and mean reverting around a permanent structural break in 1960, while the level of electricity generation grew according to a stochastic trend. Although the growth rate tended to revert to the mean, shocks tended to have long-lasting effects, with the rate of mean reversion slow. The Lumsdaine-Papell unit root test, allowing for multiple structural breaks, provides evidence that the growth rate of electricity generation in Cuba was stationary around a break in the constant in 1960 and a break in 1946, coinciding with the end of World War II. These break points are also those identified endogenously using the Bai Perron test for structural change.
countries in which the company owned properties (including Brazil, Mexico, Venezuela, Argentina, Chile, Colombia, Panama, Guatemala, Costa Rica, Ecuador, India, and China). Over the next thirty years Cuban Electric expanded service, touted repeatedly in the annual reports of A&FP. This expansion occurred, however, with periodic turmoil related to the company’s labor and pricing policies. In 1950 the World Bank organized an economic and technical mission to Cuba. Much of the commentary was quite critical of the electric power sector. The report cited the “high cost of public power” and urged industrial users, particularly sugar mills, to invest in isolated plants in order to “minimize stoppages due to hurricane damage and possible labor unrest.” The report further argued that the company probably was “overcapitalized in relation to its real value.”

A&FP continued to invest in Cuba through the 1950s, with a notable spurt toward the end of the decade.

Beginning in the late 1940s and extending into the early 1970s, the trend in the electrical sector in this part of the world was for foreign direct investments in the electrical sector to be domesticated (taken over by local interests or governments) or withdrawn. The process was sudden and dramatic in Cuba. The ultimate success of the Cuban revolution in 1959 brought in 1960 a nationalization of the company, thus ending Cuban Electric’s position as part of a global enterprise. While electricity production in Cuba does not appear to be obviously and substantially different than that in several other Latin American and Caribbean countries, there is evidence that there was a statistically significant decrease in the growth of electricity production around the time of nationalization. This suggests either that American & Foreign Power was positively contributing (adding value) to the growth of the company, or that the nationalized company was seriously under-performing. The Cuban revolution, of course, led to radical changes in the entire structure of the Cuban economy so the conclusion above can be made only with reservations.

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Figure 1: Electricity Generation in Cuba, 1931-1975

Figure 2: Growth Rate of Electricity Generation in Cuba, 1931-1975

Figure 3


Figure 4

Table 1  Summary Statistics for the Growth Rate of Electricity Generation in Cuba by Decade, 1931-1975

<table>
<thead>
<tr>
<th>Years</th>
<th>Average</th>
<th>Median</th>
<th>Standard Deviation</th>
<th>Minimum</th>
<th>Maximum</th>
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<tr>
<td>Whole Sample</td>
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<td>8.09</td>
<td>7.52</td>
<td>7.62</td>
<td>-9.74</td>
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<tr>
<td>1930s</td>
<td>8</td>
<td>5.39</td>
<td>6.58</td>
<td>7.71</td>
<td>-9.74</td>
</tr>
<tr>
<td>1940s</td>
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<td>9.27</td>
<td>7.66</td>
<td>8.39</td>
<td>3.44</td>
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<tr>
<td>1950s</td>
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<td>9.91</td>
<td>10.70</td>
<td>2.27</td>
</tr>
<tr>
<td>1960s</td>
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<td>5.07</td>
<td>5.52</td>
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<td>7.78</td>
<td>2.48</td>
<td>4.99</td>
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</tbody>
</table>

Source: Calculations by Rui Pereira