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Iraq Perspectives

An Iraq Law Update

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Introduction to Iraq Perspectives

by David J. Cynamon

This is the first issue of Iraq Perspectives, a newsletter by Pillsbury Winthrop Shaw Pittman LLP on important legal issues regarding Iraq. Iraq Perspectives is written for companies and individuals who are interested in investment and development opportunities in Iraq.

Our Iraq practice is primarily served out of Pillsbury's Washington, DC, and Abu Dhabi offices. We recently opened our office in Abu Dhabi as part of our growing Middle East practice. Lawyers at the firm represent governments and other sovereign enterprises in the Middle East on the development of major projects and their global investments. We also represent a broad range of multinational companies on their business and strategic investments in the Middle East. Pillsbury has particular expertise in the nuclear, oil and gas, technology, telecommunications, aviation and commercial real estate sectors, including extensive experience in project finance, infrastructure development and public-private partnerships.

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Project Finance in Iraq, Part 1: Project Ownership

By Christopher D. Gunson

Iraq is recovering from decades of war, sanctions and domestic unrest, and the country is in urgent need of all types of infrastructure—including power, manufacturing, transportation, telecommunications, housing, healthcare, and water. With Iraq's oil production and exports on the rise, Iraq is now in a position to move forward with these projects, for which it will need significant foreign investment. In this article, the first in a series, we consider some of the key issues involved in project finance in Iraq, particularly with respect to the challenges associated with land ownership by foreign investors and the impact that this has on project finance structures.

Why Project Finance?

A basic way to develop infrastructure projects is through straightforward contracting. A public authority enters into an agreement with a contractor to build a project, and the public authority makes payment when the contractor achieves certain milestones over the course of the project, with a substantial portion of the total contract price withheld until completion. However, this approach presents a number of risks for the contractor, including the risk that the project may not be completed and the risk that the contractor will not be paid in full. The contractor's financing options are also limited.

A project finance model is a common way to address these risks in major projects. In such a structure, the contractor or project sponsor would set up a project company that would enter into agreements with a public authority to build and operate the project. This project company would obtain financing primarily secured by the expected revenues to be generated by the project. The contractor or sponsor provides limited guarantees and most of the risk is shifted to the lender. The lender will only finance the project company if, after completing its due diligence and underwriting activities, it is convinced that the project is "bankable."

A project finance model makes it easier to blend the construction of the project with its operation, such as through a Build-Own-Operate (BOO) or a Build-Own-Operate-Transfer (BOOT) scheme. The ownership of the project may also be structured as a Public-Private Partnership (PPP), where a public authority would take a stake in the project company as a partner with the contractor or sponsor. Over time, the contractor or sponsor would transfer knowledge about the operation and maintenance of the project to the public authority.

Many projects have been successfully structured and completed through project finance models (including PPPs) in North America, Western Europe, and the Asia-Pacific region. There have also been a number of successful project financings in developing markets in the Middle East and Africa, but there are often significant challenges in creating a bankable project due to the constraints of the local legal system. One common challenge in developing markets is the issue of foreign ownership of land.

Land Ownership and Leasing in Iraq

Article 23 of the Iraqi Constitution prohibits ownership of immovable assets by foreigners, subject to exemptions provided for by law, and the Land Law of Iraq confirms that prohibition. The Investment Law of 2006 did not address land ownership, but a 2009 amendment to that law allowed foreign contractors to own private and quasi-public land for the exclusive purpose of developing housing projects, creating a clear path for project finance for residential developments. The amendment to the law also permitted long-term leases, not to exceed fifty (50) years, for the purpose of carrying out projects that have been granted an investment license from the National Investment Commission (NIC).

With this legal framework, the typical project finance model in which a project company takes ownership of the project, such as through a BOO or BOOT scheme, is problematic (with the exception of housing). Two project finance models that could be used in Iraq are Build-Lease-Operate-Transfer (BLOT) and Build-Transfer-Operate (BTO).

In a BLOT scheme, the project would be owned by the Iraqi public authority, but would be leased to the project company by way of a long-term lease agreement (provided, however, that the project was granted a NIC investment license). Ideally, the lease would be registered with the local land registration authorities to provide public notice and more certainty as to its validity and enforceability. Although a lease agreement is not equivalent to freehold ownership, lenders have accepted a lease as part of a bankable project in other developing markets, so long as sufficient assurances exist that the lease will not be terminated without cause during the life of the project.

A BTO scheme may be required for projects that Iraqi public authorities deem to be too important to the national interest to be leased to foreign contractors, such as ports and airports. In such cases, a BTO scheme would allow the project to be transferred to the public authority upon its completion, and then operated pursuant to a management agreement. However, lenders will not be able to take a security interest in the project itself if the project company, acting as borrower, has no ownership or leasehold interest.

On The Horizon – The Grand Faw Port

It was announced on March 1, 2012 that Iraq intends to develop the Grand Faw Port along its narrow coastline in Basra province. The government’s goal is for the new port to substantially increase Iraq’s oil export infrastructure and become a key international logistics hub that, combined with a rail network through Iraq to Turkey and on to Europe, could serve as an alternative to the Suez Canal. Initial tenders have been issued to construct the breakwater, but that constitutes only a fraction of the total cost of developing the port, which is initially estimated to range between US$6 billion to US$8.4 billion.

A project finance model for the Grand Faw Port might involve either a BLOT scheme (in the case of a lease agreement) or a BTO scheme (in the case of a construction contract and a management agreement). The challenge for either scheme will be to convince lenders that they can effectively take sufficient security to finance the project. Land ownership restrictions are common in the Middle East, and many projects in the region are structured as BLOT schemes. However, lenders take comfort when reviewing project finance proposals by looking at successful precedents, and no such precedents yet exist in Iraq. Creating bankable projects in Iraq, at least initially, will involve significant challenges.

One possibility to address the restriction on foreign ownership of land, and other hurdles that might arise under Iraq's existing legal system, is for Iraq's parliament to pass new enabling legislation. This could be in the form of a new law that establishes a general regime for project development, or, alternatively, a specific law that covers the development of a single, critical project. No such legislation has been proposed, however.

In Part 2 of this series, we will examine the issues that arise under offtake agreements, which secure revenues to a project company through long-term contractual commitments.

Iraq’s National Investment Commission

By Mostafa El-Erian, Esq.

The Investment Law of 2006 established the National Investment Commission (NIC), the Iraqi government institution responsible for promoting investment by granting licenses to develop major projects. The NIC actively assists investors to identify potential projects and coordinates on behalf of investors with Iraq’s ministries and government agencies. For investors seeking to do business in the country, the NIC has established a One-Stop Shop (OSS) for navigating Iraq’s complex bureaucracy, including clarification of the rights and responsibilities of central and provincial agencies.

NIC Investment Licenses

The investment licenses are granted not to the investors themselves, but to specific projects. Projects that receive an investment license enjoy a number of benefits under Iraq’s tax and currency control laws. The projects are exempt from taxes and fees for a period of ten years (from the date of project start-up), increasing to fifteen years if the project is at least 50% owned by Iraqi investors. An investment license also exempts remittances related to the project from repatriation restrictions, allowing investors to repatriate capital and profits. It also allows non-Iraqi employees to repatriate their salaries overseas without restrictions (after they have paid local Iraqi taxes).

The NIC is open to applications for investment licenses from domestic and foreign investors, and has identified projects throughout Iraq in a number of sectors where it is seeking foreign investment. Investment licenses are available to be granted for projects in every sector, except oil and gas exploration and production, banking and insurance services.

The OSS serves as the single point of contact for NIC investment license applications. An investment license application must also include a feasibility study for the project that covers economic and technical aspects of the project, proof of financial support, and past performance of the project sponsors. There are no charges for the NIC application.

The NIC’s broad mandate and latitude in negotiating and granting investment licenses presents a unique opportunity for investors who appreciate Iraq’s potential as a major emerging market.

Developing Iraq’s Investment Zones

Iraq is planning to establish “Investment Zones” to attract investors into specialized industry clusters. The provisions of the draft “Investment Zone Regulation” authorize the NIC to supervise the development of the Investment Zones, including the designation of their locations, supervising feasibility studies, licensing the developers, and monitoring the users.

Iraq already has a legal system that permits foreign investment in most sectors, and the investment license granted by the NIC provides material incentives and protections to investors. The primary purpose of the Investment Zones, therefore, is to provide coordinated administrative and logistical services and necessary infrastructure facilities in designated areas (and generate local employment opportunities).

The NIC is working with provincial investment commissions and preparing tenders for feasibility studies to develop the first 6 Investment Zones:

- an industrial zone in Babil Province
- a commercial and air cargo logistics zone in Baghdad Province
- a petrochemical and port cargo logistics zone in Basra Province
- a construction, glass and ceramics zone in Anbar Province
- a specialized mechanical industries zone in Ninewah Province
- a foodstuffs industries zone in Karbala and Najaf Provinces.

Iraq is now prioritizing its infrastructure redevelopment with an emphasis on direct foreign investment and technology transfer. Foreign investors will be interested in safeguards and guarantees that address perceived and actual risk. Iraqi law regarding foreign investment is arguably one of the most investor-friendly in the Middle East, and the NIC is a critical contributor to the success of any major project.

Mr. El-Erian is the founding partner with El-Erian Associates, LLC in Washington, DC. He is currently implementing technical assistance programs and developing infrastructure projects in the Middle East, particularly in Algeria, Egypt, Iraq and Libya. Since 2003, Mr. El-Erian has been involved in the U.S. and U.N. reconstruction efforts in Iraq as an advisor to senior Iraqi officials and parastatal entities, and to private sector investors. He previously worked in project finance with the World Bank and in private law practice in the United States.

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