Project Financing In Iraq: Weighing Up The Risks

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June 11, 2012

Iraq is open for business and investors are lining up. Major infrastructure projects are springing up all over Iraq, as the country is recovering from decades of war, sanctions, and domestic unrest. There is a dire need for an array of infrastructure investments – particularly, in the areas of healthcare, housing, power, water, manufacturing, transportation, and telecommunications. Construction projects are being launched throughout Iraq, even in the most remote areas, for which significant foreign investment will be needed. Public entities in Iraq are finding it difficult to provide the large amount of funds and resources needed for these infrastructure projects and, as a result, foreign investors are expected to become important financiers.

But should a prudent foreign investor consider financing such projects? Under the current Iraqi investment law, there are several options available to foreign investors depending on the business needs and activities to be exercised in Iraq. However, the political reality seems to be a major discourager, perhaps only to those who do not perceive risk as opportunity.

Incentivising Foreign Capital

In 2006, Iraq enacted several investment laws at the federal, regional and governorate level in order to stimulate investment and development of infrastructure projects. These laws also aim at encouraging Iraqi and foreign private sectors to invest in Iraq, to create employment opportunities for Iraqis as well as to improve the balance of payments.

Investment Law No. 13 of 2006

Investment Law No. 13 of 2006 (the "Investment Law") provides investment incentives and establishes the National Investment Commission ("NIC") with the authority to grant investment licenses for projects determined to be of national and strategic importance. The purpose of the NIC is to serve as a single point of contact for investors who are interested to invest in Iraq. The remit of the NIC is to facilitate investment in strategic projects which include (a) projects of capital not less than USD 250,000; (b) projects related to the extraction of natural resources (excluding oil and gas); (c) projects arising from an agreement where the Republic of Iraq is a party therein; (d) petrochemical, pharmaceutical, or industry projects, involving the manufacture and production of vehicles; (e) transportation projects (roads, ports, airports, etc.); and (f) electricity projects of production capacity not less than 30 megawatts. Notably, projects with a minimum capital USD 1 billion are generally considered as strategically important by the NIC.

Benefits of an investment license include exemptions from project taxation for a period of 10 years; exemption from customs duties for a period of 3 years; right to lease land needed for a project for a renewable period of 50 years; guarantee that non-Iraqi investors and workers on investment projects shall have a right of residency and facilitation of entry and exit from Iraq; right to repatriate capital and assets in accordance with the law and instructions issued by the Central Bank of Iraq; and a guarantee that the project will not be nationalised, except by way of final court ruling. On the other hand, the investment license would lead to some burdens on the licensee such as employing a certain quota of Iraqi citizens, providing economic and technical feasibility studies, submitting certified and audited financial records as well as work progress schedules. The Investment Law has been criticized for not advancing any additional incentives to what was previously available, and for only imposing burdensome prescriptions and conditions.

Kurdistan Investment Law

The Kurdistan Investment Law No. 4 of 2006 provides a more attractive legal framework for investors. Tax exemptions are, for instance, more comprehensive and investors can also obtain freehold land rather than a lease for the purpose of a licensed project. In summary, the two laws provide much-needed guarantees and facilitations (transfer of capital, repatriation of money, etc.) and explicitly permit for international arbitration as a means to resolve investment-related disputes.

Whilst the legal framework seems to create an appetite for foreign investors, the political scenario can have the opposite impact, especially in light of the withdrawal of US Troops in December 2012. In addition, the federal government is continuously making it difficult for foreigners to obtain entry visas or residencies, and some legal procedures relating to the incorporation of companies remain onerous and time-consuming.

Pre-engagement Checklist

Project financing uses long-term contracts such as construction, supply and concession agreements, along with a variety of joint-ownership structures. Therefore given the long term commitment and substantial investment by investors in these projects, it is absolutely critical to take adequate measures to mitigate all associated risks. Although there is no silver bullet through which a foreign investor can eliminate all project risks, the following measures should be considered carefully to mitigate the risks associated:

> *Conducting Enhanced Due Diligence.* Due diligence is critical in Iraq and therefore necessary techniques and methods should be developed. Foreign investors should consider whether local contractors in Iraq have the right background, people, and systems, and a genuine commitment for bringing the project to fruition. A thorough review of the legal and regulatory regime should be conducted to ensure that all laws and regulations are strictly complied with and all the correct procedures are followed with a view to reducing the scope for challenge at a future date.
> *Analyzing Asset Title.* Consideration needs to be given to the ownership of the asset (or land) being developed in Iraq. Given the restrictions on some forms of land ownership, arrangements should be made in order to protect investor's interests.
> *Obtaining Assurances.* Foreign lenders should obtain assurances from the Government in Iraq, especially with respect to the availability of consents and permits. Obviously such assurances are still subject to performance risk, but at a minimum they can make it difficult, as well as embarrassing, for a government to walk away from an assurance given earlier in connection with a specific project, on the basis of which foreign investors have participated in that project
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> *Examining Financing Structure.* It is equally important to thoroughly study the structures available for project financing, including the advantages and limitations of each available model. It is important to identify and allocate risks involved in the project, and develop and implement methods to manage those specific risks. In this regard, public private partnerships are becoming increasingly popular, with private financiers taking on construction and operating risks while governments cover market risks.

§ *Risk Sharing.* One of the most effective ways of managing and reducing political risks is also to lend through, or in conjunction with, multilateral agencies such as the World Bank, and the European Bank for Reconstruction and Development. There is a view that, where one or more of these agencies is involved in a project, the risk of interference from the government is reduced on the basis that the government is unlikely to offend any of these agencies for fear of cutting off a valuable source of credits in the future.

§ *Requiring risk mitigation provisions in the contract.* Negotiating and drafting contracts can be challenging and disputes commonly arise over risk mitigation provisions. When negotiating and drafting agreements, foreign investors must carefully choose their language and avoid boilerplate provisions that can have severe unintended consequences. For example, the government might suggest to a foreign investor that any disputes be resolved by resorting to local courts in Iraq – a suggestion that should be summarily rejected by even the most unseasoned foreign investor.

§ *Securing Insurance.* To keep a lid on risks, insurance is a must. Managing political risks has long been an important element of international project financing. Political risk insurance is one of the primary tools lenders and investors use to manage these risks. It is important to note that insurance cannot not make a bad deal better and is not an all-risk guaranty. As a result, foreign investors should identify risks implicated by the transaction and make decisions accordingly.

Conclusion

Iraq has a bright future, and this will only be enhanced as the legal framework for project financing is more fully and consistently developed. The opportunities in Iraq, however, are not without their unique challenges. The region is volatile, but so is much of the developing world. Investing in any developing nation involves some risk. However, for those who go into it being aware of those risks, and with a plan for mitigating them, the outcome can be rewarding. Iraq is definitely not a place to enter lightly. It requires a serious approach, a long-term commitment, and a deep knowledge of the intricacies of doing business in what is truly rich and attractive part of the world. Interestingly, the Kurdistan region remains significantly distinct from the rest of Iraq and is gaining favor because of its investment friendly policies. Kurdistan also has a low-risk security climate as compared to other places in Iraq. As a result, Kurdistan is attracting investors by offering its autonomy as a secure gateway.

Diaz, Reus & Targ LLP will be keeping a watchful eye on the opportunities being offered by Iraq. The firm has recently opened offices in Iraq, further expanding its presence in the Middle East and reinforcing its long-term commitment to the region. Our worldwide offices are working closely with our Iraq offices to ensure that we are well placed to assist foreign contractors, investors and lenders who wish to set up and implement development projects in Iraq. Diaz Reus operates offices in Miami and Orlando, Florida; Caracas, Venezuela; Shanghai, China; Dubai, U.A.E.; Iraq; Frankfurt, Germany; Bogota, Colombia; Panama, Republic of Panama; Mexico City, Mexico; Buenos Aires, Argentina; Santiago, Chile; and an affiliate office in Sao Paulo, Brazil. For more information, visit www.diazreus.com.