

LEGAL GUIDE TO INVESTING IN POWER GENERATION IN IRAQ



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FOREWORD BY THE CONTRIBUTING AUTHORS

In an effort to promote foreign investment in Iraq, the Commercial Law Development Program (CLDP), along with other key partners, has been developing material to guide potential investors. In 2015, the CLDP published the Legal Guide to Investment in Iraq, a bilingual Arabic-English guide to general investment practices in Iraq. It outlined relevant Iraqi legislation with an emphasis on the recently enacted National Investment Law, delineated critical investment procedures for key economic growth sectors, and provided a model investment contract.

The present Legal Guide to Investment in Power Generation in Iraq (“Legal Guide”) follows those efforts by focusing on a sector that is in particular demand by the people of Iraq and accordingly can benefit from private sector involvement. Specifically, Iraq has suffered, in the past decade, from a chronic power shortage, which has not been alleviated from traditional public sector development and operations. Given the significant gap between supply and demand for power, as well as the Iraqi government’s commitment to this sector, investment in power generation offers considerable opportunities for investors willing to assume associated risks.

As outlined below, this Legal Guide is intended to provide a general introduction and up-to-date overview of certain aspects of the structuring and legal regime for investment in power generation in Iraq. Of special note, the specific nature and location of a project, as well as changes to the Iraqi legal regime, may affect the information included herein. In particular, there may be different regulations and requirements in the Kurdistan region of Iraq which are not covered by this Legal Guide.

Chapter I outlines how both the private sector and the government should approach power projects together. In addition, this chapter lists the factors that create an investor friendly environment and provides case studies of how other countries in the region have approached investment in the power sector.

Chapter II delves into Iraq power sector’s and legal landscape. It describes the power sectors’ supply and demand, as well as relevant government agencies, financial institutions that are active in the country , legislation ranging from land rights to tax laws and dispute resolution mechanisms.

Chapter III introduces power project financing and describes typical project finance structures, as well as various ways to structure these types of transactions given the Iraq context.

Chapter IV describes what elements of a power project influence its bankability, as well as considerations for both the seller and the buyer in the negotiation of a Power Purchase Agreement (PPA).

Chapter V continues to build on PPA bankability by outlining common risks in financing a power project and providing mitigation measures both generally and specifically in Iraq.

As investment in the power sector increases, we expect this sector and Iraq to evolve and as such envision that this Legal Guide will be updated to follow that evolution.

For questions or further information on the contents of this Legal Guide, please contact Adam Al-Sarraf (aal-sarraf@doc.gov) and Marc Tejtzel (MTejtzel@doc.gov) at Commercial Law Development Program (CLDP).

* * *

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CHAPTER I. THE POWER SECTOR

A. INTRODUCTION

This chapter addresses the features of the power sector generally, with a special focus on the current condition of the power sector landscape in Iraq. In addition to an overview of financial and regulatory requirements for a healthy power sector, a survey of independent power generation in key emerging markets is provided to shed light on the particular challenges Iraq might face as it continues to develop its own power sector.

B. EVOLVING MARKET STRUCTURES

1. PRIVATE CAPITAL, PUBLIC GOOD

Competing demands on government funds and limited financial solvency in the power sector have constrained the ability of many emerging market governments to invest in additional power generation capacity. This has occurred against the backdrop of an unmet and growing demand for power.

While attempting to address the needs of its power sector, Iraq will need to balance political, economic, and fiscal considerations. Governments are often unable to fund the necessary capital expenditures required to meet their power infrastructure needs; however, partnering with the private sector would offer the Iraqi government the opportunity to access greater financial resources and technical expertise. The integration of the private sector into the power sector not only shifts the financial burden away from the government, but also shifts some of the risks such as project preparation, implementation, and operation to the private sector.

In emerging markets, power sector markets typically start out as fully government financed, owned, and operated. While this model requires less coordination by the government in terms of various third-party funders, it often requires the government to add a greater financial burden to its balance sheet. This can limit the available cash reserves or external financing that a government can channel to other capital-intensive sectors that it may need to support. Further, due to other priorities, the government may allocate insufficient funds for the power sector to function at its optimal capacity, although, as will be discussed in Chapter III (*Financing of Power Projects*) of this Legal Guide, governments can sometimes be very efficient both in construction and in operation and maintenance. Consequently, many governments have deemed it beneficial to privatize certain revenue-generating power assets (primarily generation assets), which may be more attractive to investors, to free up government funds for social sectors such as education and health. In this vein, the Iraqi government may benefit by encouraging private capital that frees up the government's balance sheet for critical social service-related priorities.

2. TOWARDS A MORE DEVELOPED POWER SECTOR

Despite growing private participation, the provision of power is a public good that may require the active engagement of the Iraqi government. This level of engagement exists in varying degrees in different countries.

Within emerging markets, there is a wide continuum along which power markets evolve. On one end of the continuum, there are markets that are tightly controlled by their governments, with single offtakers and limited access to the grid. On the other end, there are countries that allow for spot market auctions, wheeling arrangements and multiple offtakers. The more a government advances towards the latter position, the less government support is required.

As the market structure evolves, private participants gain comfort from greater transparency and a more efficient allocation of resources. As the market matures, it is likely to attract greater private investment and be better positioned to weather most of the volatility that may be generated by macroeconomic events and trends. As the market moves towards becoming self-sustaining and financially solvent, the government will continue to play a critical role; however, it may no longer be necessary to subsidize the cost of power production. Nevertheless, until the full benefits of privatization and liberalization have, or are perceived to have, produced a relatively developed power market, the government may still be called upon to provide financial support or guarantees in an effort to create an enabling environment conducive to developing the market.

C. CREATING AN ENABLING ENVIRONMENT

In order to maximize the efficiencies of private participation in power markets, there are certain legal and regulatory measures that may be implemented in Iraq to assist in developing a more mature private power sector. Failure to implement these measures could cause market inefficiencies, which may ultimately result in a cost to the government, due to the moral hazard, where the market would ultimately rely on the government to manage these inefficiencies and bear the risks. Conversely, the application of certain key market reform measures should help ensure a competitive price for power and allow for a greater transfer of risk and responsibility from government to private market participants.

Iraq will need a stable, consistent, and investment-friendly framework of laws and regulations in order to attract private investment. The government will have the primary responsibility of creating such an environment. The laws currently in place provide incentives for private investment and also provide assurance that disputes will be properly resolved. (See Chapter II (*Iraq Power Sector's Finance & Legal Landscape*) of this Legal Guide for more detail regarding the current framework in Iraq and the benefits that are in place for foreign and private investors.)

Summarized below are some critical factors that private investors will review to understand a country's legal and regulatory framework. A review of the general

enabling environment, as well as the project structure, will often be the starting point for investor negotiations that may result in the investor requesting additional assurances, such as credit enhancements, from the host government and/or the offtaker.

1. POWER SECTOR POLICY, LEGISLATION, AND REGULATORY FRAMEWORKS

Laws that clearly define the roles and rights of the various government entities and private parties involved in the power sector will enhance the attractiveness of the electricity market for potential investors. This often entails government parties clearly allocating certain rights and remedies to private market participants that can be relied upon when evaluating potential investments. By firmly setting these rights and remedies in law and regulation, the government is limiting its flexibility but is also attracting private investment.

An independent regulator also plays a critical role in upholding and balancing the rights and interests of all stakeholders by comforting investors that decisions regarding licensing, provisioning, and tariffs will not be made arbitrarily. Inversely, the regulators will seek to protect end-users from sudden or disproportionate tariff increases.

2. SECURE OWNERSHIP RIGHTS

Having a system that allows for security of ownership rights is essential for any investor. In project finance, lenders would require certainty that they can exercise step-in rights and take over the project company and its assets in the event of loan payment defaults.

3. COMMERCIALLY VIABLE SECTOR

One critical aspect in ensuring the longevity of a power project is having cost-reflective tariffs to ultimately assure that the offtaker (and other utilities) can retain favorable margins, and in turn, further finance the growth of the sector. When the tariff paid by the end-users of power accurately reflects the cost of producing that power and transmitting and distributing it to the end-users (including the cost of capital commensurate with risk), no subsidy is required by the government for the power sector. However, if the tariff does not accurately reflect such cost, the utility will be a loss-making entity unless alternative sources of funds are found to cover the deficit. This may impact investor confidence in the offtaker to meet its ongoing payment obligations over the course of a long-term purchase agreement.

However, increasing electricity tariffs to cost-reflective levels compatible with the realities of an emerging power market, such as Iraq, can be challenging, especially where supply is intermittent (i.e., brownouts, blackouts), thereby creating political pressures to maintain low electricity prices. This needs to be balanced against the consequence of having a financially insolvent power sector, which may otherwise necessitate additional financial support from the host government to attract further

investment. This makes it imperative for the Iraqi government to manage the twin challenges of investor and consumer confidence.

Even if the offtaker benefits from a cost-reflective tariff, it will remain a loss-making entity if it is unable to collect from end-users and customers, including, in some jurisdictions, distribution companies. Having a robust system of metering and bill collections is of critical importance, in addition to cost-reflective tariffs, for the financial solvency of the power sector. Further, minimizing the technical and commercial losses from transmission and distribution is critical to ensuring proper cash management in the system.

The private sector plays a key role in ensuring a commercially viable power sector. Sponsors who build and operate efficient plants that attain the end goal of providing electricity in a sustainable and cost-effective manner are required in this long-term partnership.

D. GLOBAL EXAMPLES OF POWER GENERATION

1. INDEPENDENT POWER GENERATION IN EMERGING MARKETS

The rationale for early reforms promoting private investment in and ownership of power generation assets in countries such as the United Kingdom and Chile was largely focused on increasing the sector's efficiency and lowering the tariff. Electricity consumers in these countries enjoyed universal access to reliable services and demand was generally satisfied through either public investments or private investments by heavily regulated utilities. In this regard, reforms in developed countries sought to increase competition on different levels and create markets for supply and electricity services. Some countries (e.g., Chile and the United Kingdom) pursued this objective through unbundling and privatizing public utilities, while others (e.g., Norway, Sweden, New Zealand, and Australia) pursued it through substantial public ownership within liberalized electricity markets. This was in stark contrast to the needs of many developing countries that faced a different set of challenges.

By the late 1980s, the electricity sectors in many developing countries suffered from poor technical and financial performance resulting from a confluence of factors. While governments may have intended to subsidize end-user tariffs, fiscal constraints sometimes led to underpayment of these subsidies, leaving the utilities to bear the financial burden of carrying the shortfall. This issue was further exacerbated by chronic underinvestments in maintaining the sector's generation, transmission, and distribution assets, and in training and building capacities of utilities' staff. The power sector also worsened due to public employment policies that forced utilities to retain more staff than were needed for efficient operations.

The result was significant deterioration in the technical and financial performance of the sector. A survey of 60 countries in the late 1980s noted that electricity utilities were able to support only 12% of their investment requirements. There were also

clear indications of problems in utility productivity per employee and in the reliability of electricity services. In regions such as sub-Saharan Africa, this translated to very low access rates with the bulk of the population lacking access to electricity. Those fortunate enough to have electricity access received unreliable supplies with frequent blackouts or brownouts. For developing countries facing these challenges, reforms meant increasing tariffs in order to address some of these issues. The reforms also meant significant investments in new generation, transmission, and distribution infrastructure that required financing beyond the capacity of the public sector. As a result, private sector participation and competition were generally viewed as the solution to improve electricity sector performance.

2. CASE EXAMPLE I: PAKISTAN

Pakistan was one of the early examples of developing countries outside Latin America to attempt to resolve the power sector performance issues. In the late 1980s, the country developed a framework to attract private sector participation in its electricity sector. The framework sought to address issues related to incentives, repatriation of profits and capital, availability of foreign exchange, electricity pricing, and institutional capacity to review, negotiate, and approve private sector projects. By 1992, the Government of Pakistan (GoP) adopted a strategic plan to unbundle the sector, separating generation, transmission, and distribution operations, with the intention to eventually privatize them. The plan also encouraged private sector participation in generation and called for establishment of an independent regulator to oversee sector operations. The government established the Private Power and Infrastructure Board as a “one-stop shop” to negotiate the private financing agreements and security packages on behalf of the government, and the Water and Power Development Authority (WAPDA) Private Power Organization (WPPO) to negotiate PPAs on behalf of WAPDA, the then vertically-integrated incumbent electric utility.

Pakistan’s efforts were quickly rewarded when the US\$1.6 billion, 1292 MW Hub River Power Project (Hub), the first privately-owned, independent power project (IPP) in the country, was signed in 1994. The country used a slightly modified form of Hub’s contractual framework as a model under a new 1994 Private Power Policy that proved to be successful in attracting private sector investments in generation. The GoP entered into letters of support for 34 projects for more than 9,000 MW under a tariff ceiling established by the policy. Among these, a total of 16 projects, representing approximately 4,000 MW, reached financial close and were able to proceed. These projects raised a total financing of US\$5.3 billion, of which US\$1.3 billion was financed by foreign equity. Some of the contributing factors behind this success were the clear policy framework that followed the government’s vision and intentions in the sector and the established indicative bulk tariffs with indexation mechanisms for fuel and inflation. Attractive fiscal incentives, a standardized, bankable contractual framework for private power projects, and a “one-stop shop” for investor interactions were also key developments implemented.

However, Pakistan's early success ran into significant challenges, as efforts continued throughout the 1990s and early 2000s to develop more IPPs. While the country aggressively pursued implementation of the 1994 Private Power Policy to increase private sector participation in generation, implementation of reforms in the rest of the sector lagged. Although fuel and inflation indexation of bulk tariffs for IPPs was one of the success factors of the IPP program, it strained the WAPDA's cash flow, which depended on revenue from government-mandated retail tariffs that did not pass these costs through to customers (a misstep that Egypt would repeat in late 1999 and the early 2000s with its first three IPPs). Operating inefficiencies on WAPDA's system also meant that system losses prevented recovery of a significant portion of the costs associated with power purchased from IPPs. Furthermore, the selection criteria used for IPP projects were opaque and subject to political influence. This led to perceptions of corruption by successive governments and several attempts to terminate IPP contracts without credible evidence of malfeasance. This damaged perceptions of the country's investment environment.

Moreover, the location, size, technology, and fuel choices in selected projects were not consistent with least-cost expansion planning, which resulted in unnecessarily increasing project costs and risking their long-term viability. While the adopted ceiling bulk tariff was designed to accelerate private sector participation, some argued that it may not have provided sufficient incentives for innovation and cost reduction by private IPP sponsors that would normally result from competitive bidding. As technology and IPP costs continued to decrease in other countries, there was a perception in Pakistan that IPPs in their country were over-paid – although subsequent analysis proved this not to be true – which increased the political pressure and tension with IPPs.

3. CASE EXAMPLE II: TURKEY

While Pakistan elected to approach sector reform in a phased approach, starting first with introduction of competition by IPPs at the wholesale level that largely preserved the status quo in the sector's structure, other countries elected to follow a different path. Turkey, for example, began reforming its power sector in the 1980s as it was emerging from a severe economic crisis in the late 1970s, a military coup in 1980, and political turmoil in the early 1980s. The Turkish Electricity Authority (TEK), which was originally established in 1970 as an integrated utility for electricity generation, transmission, and rural electrification, became a monopoly in 1982 when it absorbed municipal distribution operations that were independent at the time.

Turkey reversed course in 1984 when it adopted a new law removing TEK's exclusivity over electricity generation, transmission, and distribution, allowing IPPs under three models: build-own-operate (BOT), transfer of operational rights (TOOR), and self-generation. TEK was "corporatized" into a state-owned enterprise that was later split into the Turkish Electricity Generation and Transmission Company (TEAŞ) and the Turkish Electricity Distribution Company (TEDAŞ). TEAŞ was designated as electricity buyer from IPP schemes under BOT and TOOR models, and TEDAŞ was designated as electricity buyer from self-generators.

Development of the wholesale market commenced under the three models provided under the 1984 law. The TOOR model, which provided for the transferring of operating rights of public assets to private management, was used many times during the 1980s and 1990s to attempt to attract private investments. Investors were expected to make new investments in the public assets they controlled for the duration of the TOOR contract. However, most of these attempts ultimately failed because of fundamental legal issues in the transfer of public assets to private management, unavailability of sovereign guarantees (for generation) before 1994, and regulatory uncertainties.

The self-generation model, though in existence prior to the 1984 law in mostly state-owned enterprises and cogeneration plants, was used extensively for wide-spread investments. The pace increased after regulations were adopted in 1994-1999 allowing companies to set up jointly-owned plants. By 2001, approximately 2,300 MW had been installed.

Legal uncertainties surrounding the BOT model delayed its implementation until a new law was passed in 1994. In addition to addressing the legal uncertainties, the 1994 law also provided for sovereign guarantees by the Turkish government for TEAŞ payments under PPAs. These changes resulted in a flood of unsolicited proposals for new generation projects – in all, 200 proposals were submitted that, if implemented, would have tripled Turkey’s generation capacity. Ultimately, 24 PPAs (for a total capacity of 2,450 MW) based on the BOT model were negotiated and executed, but the government decided to focus more on priority projects of its own choice rather than to review and compare hundreds of unsolicited proposals. The government also decided to award projects on a competitive basis to secure more reasonable prices and conditions. The BOT model was tweaked to remove the requirement for transferring the assets to TEAŞ at the end of the PPA, thus turning it into a build-own-operate (BOO) model, to improve bankability. Five PPAs (for a total of 6,100 MW) were signed on a BOO basis.

Although the BOT/BOO approach could have generated more investments in generation capacity, Turkey elected to change course again. There were allegations of irregularities in the contracting process that galvanized public opinion against continued state control of the sector. Moreover, as BOT/BOO projects involved sovereign guarantees, the government became increasingly weary of the contingent liabilities these guarantees presented. This issue was further exacerbated by an economic slow-down that reduced electricity demand growth, making security of supply to meet increasing demand no longer a sufficient justification for state guarantees. Further, the take-or-pay obligations in the existing contracts increased the risk of state liability as the possibility of market over-supply emerged. Lastly, as Turkey was considering membership in the European Union, which espoused market-based approaches for wholesale supplies, the government began to ponder similar methods.

By the early 2000s, Turkey had adopted laws to provide the legal and regulatory framework for a competitive market where multiple buyers and sellers could

transact. The government was intent on privatizing the sector, but concluded that it must privatize TEDAŞ (distribution) before it could privatize generation. The government's rationale was that creating a reliable distribution operation would give confidence to potential private investors in generation companies. At the time, TEDAŞ's distribution operation did not inspire this confidence. If generation privatization proceeded, state guarantees may have been required to backstop TEDAŞ's obligations in the sector, which was the environment in which the legacy BOT/BOO IPPs were developed.

To avoid this situation and develop market competition, the government adopted open, non-discriminatory regimes for access to the transmission and distribution networks that facilitated bilateral trading directly between generators and wholesale consumers. The government also required transition arrangements and sequencing of actions to move from a monopolistic "Single Buyer" model, where a state-owned entity acted as the counterparty in PPAs and sold power to wholesale customers, to bilateral wholesale competition. The objective was to establish a transparent, competitive environment to attract private investments and promote efficiency through competition.

To implement this vision, TEAŞ was further split into the Turkish Electricity Transmission Company (TEİAŞ), the Electricity Generation Company (EÜAŞ), and the Turkish Electricity Trading and Contracting Company (TETAŞ). TEİAŞ owned and operated the transmission system, while EÜAŞ owned and operated the public generation facilities and TETAŞ managed wholesale activities, including the legacy BOT/BOO PPAs for the 8,550 MW that existed at the time. TEDAŞ was also restructured in 2004-2006 into a holding company and 20 regional distribution subsidiaries to prepare them for the privatization that took place in 2008-2013.

Moreover, an independent regulator was established to oversee sector operation and prepare regulations necessary for licensing, tariffs for regulated activities, transmission and distribution grid codes, market opening, market rules and procedures, balancing and settlement mechanisms, and more. Regulated activities included (a) transmission, (b) distribution, (c) retail sales and retail sale services to captive consumers (whose consumption was below a certain threshold), and (d) TETAŞ's wholesale activities. Activities that were not regulated included generation, wholesale transactions except for TETAŞ's activities, and retail sales to non-captive consumers.

As economic growth began to pick up in Turkey and the risk of looming power shortages from 2009 onward increased, the government revisited its regulated tariffs after a 5-year gap with little or no increases. This hiatus significantly contributed to the low level of private investments in the sector at the time and to the deteriorating financial performance of the public distribution companies. The government raised the tariffs to cost-recovery levels by 2008 and adopted an automatic, cost-based pricing mechanism to ensure full cost-recovery in the future. This step preceded the generally successful privatization of the distribution companies in the 2008-2013 period and the generation privatization that followed.

While the government was taking steps to reform the sector, investments in new generation capacity came mostly from IPPs. Between 2002 and 2015, 43,100 MW of new generation facilities were commissioned, with the bulk (74%) of this capacity developed, owned, and financed by private companies. The majority (88%) of these private investments came after 2007 when the government undertook tariff reforms, with annual investments of US\$4 billion in the 2008-2014 period. Except for investments in renewable energy projects under prevailing feed-in tariff regimes, these generation investments were made without any take-or-pay guarantees from the government, in contrast to the legacy BOT/BOO transactions. By 2014, 13 years after the 2001 reforms, market-based generation capacity accounted for the majority of Turkey's power supplies.

1. INDEPENDENT POWER PROJECTS – LESSONS LEARNED FROM DECADES OF REFORMS

The standard prescription restructuring reform efforts in Latin America, England and Wales, and Norway in the 1980s and 1990s focused largely on vertical and horizontal unbundling and privatization of generation, transmission, and distribution functions, and the creation of independent regulatory agencies to oversee sector operations. This standard model aimed to liberalize markets where competitive forces determined prices in the wholesale and retail electricity supply markets. Experience over the past 25 years illustrate that this standard model, which requires a certain level of sophistication of the legal and regulatory frameworks in which it is implemented, may not be suitable for all countries. Even when suitable, the time-frame in which it can be implemented varies widely by country based on a variety of political, economic, financial, and social factors that are specific to each country.

One of the key lessons learned from power sector reforms worldwide is that there should be a holistic approach to addressing sector deficiencies. Generally, private participation in the sector becomes attractive when utilities and governments are no longer able to sustain the public investments needed to maintain availability or reliability of electricity services. This typically stems from successive policies that prioritize short-term fiscal and social objectives over the sector's long-term sustainability. At the heart of this bargain are tariff policies that significantly contribute to deterioration of the sector's financial and technical performance. At the same time, chronic technical mismanagement of the sector adds to this deterioration and lends credence to public resistance to solving the sector's fiscal challenges until technical performance improves, regardless of public or private ownership of the assets.

Morocco, for example, has a mix of public and private ownership in its electricity sector. A significant portion of its generation is provided by IPPs and electricity imports from Spain, and the distribution systems in most of Morocco's large cities are privately operated under competitively awarded concessions. The transmission system and the balance of generation and distribution assets are owned by the national utility (along with public municipal utilities in certain rural areas). From

2014 to 2015, Morocco phased out indirect subsidies in the sector that aimed to defray some of the fuel costs of public generation plants. Nonetheless, the country still provides a small subsidy to cover the difference between the national utility's cost of service and the retail tariffs approved by the government. Rather than giving this subsidy to the utility outright, the Ministry of Finance (MoF) agreed with the utility on a contract program whereby subsidy payments were linked to achieving key performance indicators that target improving the utility's operational and financial performance.

The reality is that, in order to be comprehensive enough to lead to meaningful change in sector performance, sector reform takes a long time. In the meantime, increasing electricity demand requires investments in additional generation capacity that public budgets may find difficult to support, particularly in fiscally constrained countries. Private participation in generation provides some relief by shifting the initial capital outlays to construct new generation capacity away from relying on public resources. This helps in meeting the short- to medium-term capacity needs of a country and provides time to design and implement necessary reforms to ensure the sector's sustainability. IPPs can be added to the sector on the basis of a contractual framework, as further discussed in this Legal Guide, which obviates the need for comprehensive legal and regulatory frameworks to govern the power sale transactions.

It is important to note, however, that opening the sector to private participation through IPPs without contemporaneous efforts to implement comprehensive reforms can have negative consequences. When executed properly, IPPs can provide required generation capacity at the lowest possible price, but an IPP's contractual structure is designed to ensure recovery of this price if the private operators deliver what they agreed to. Unlike public utilities, whose budgets are subject to annual or periodic reviews and which can be restricted based on the fiscal pressures of the time, the costs of private power are contractually set. As illustrated in many countries, public utilities attempt to cope with significant reductions in their budgets by slashing operation and maintenance budgets, even when it severely reduces the useful life and investment value of public assets, or by deferring payments to their creditors. IPPs, whose costs are largely fixed, do not have this flexibility. Delays or deferrals of IPP payments to its creditors or operation and maintenance costs can have dire consequences.

In other words, private participation in generation commits the national utility and, often in cases where this utility is not financially viable, the associated government to costs that cannot be easily changed. For example, if retail tariffs are not cost-reflective, fiscal strains will grow as the difference between the cost of power from IPPs, on the one hand, and revenues from the sale of this power to retail customers, on the other, widens. Egypt learned this lesson when it first introduced IPPs in late 1999 and the early 2000s. Differences in indexation of the dollar-denominated IPP

tariffs and the Egyptian pound-denominated retail tariffs created significant strain on the public budget to finance the shortfalls in revenue collected from consumers for power generated by IPPs.

By the same token, disruptions or inefficiencies in the transmission or distribution networks and, if provided by public entities, fuel supply could lead to rolling blackouts or brownouts as the public utilities attempt to cope with their consequences. However, as such disruptions or inefficiencies are not in the IPPs' control, they typically do not affect the utility's payment obligations under PPAs, if the IPP was otherwise available to provide power, even if the utility did not actually generate any revenue to cover these payments.

In sum, private participation in generation is a very useful tool in addressing immediate needs for new capacity without relying on public financing. However, introduction of IPPs should be viewed as the first step in a broader plan to make the sector more self-sustainable. As experiences in Pakistan and other countries demonstrate, the longer it takes to implement this broader plan, the higher the risk that significant government support will be needed to sustain the sector.

CHAPTER II.

IRAQ POWER SECTOR'S FINANCE & LEGAL LANDSCAPE

A. INTRODUCTION

This chapter will provide an overview of the power sector in Iraq, including the Electricity Master Plan that was developed in 2010 by the Ministry of Electricity (MoE). Further, this chapter will discuss a few key regulatory agencies and institutions and their roles in the power sector. In addition, land rights, incentives for IPPs, investor obligations, and lender rights, as well as fiscal policies and provisions specific to the power sector, will be examined. Lastly, the chapter will explore how business is conducted in Iraq, from the formation of a company to the implementation of the project, and success stories in the power sector and challenges that a foreign investor may face in Iraq.

B. IRAQ POWER SECTOR

1. IRAQ POWER SECTOR BACKGROUND

Iraq is among the countries most endowed with energy resources. However, electricity supply has been inadequate to meet both the demands of Iraq's population and the country's needs for economic growth. The consumption of electricity (recognized sales) in 2010 for Iraq was approximately 8.3 gigawatts (GW). However, the peak demand for electricity in Iraq was estimated at 13.7 GW. This outstanding deficit between supply and demand has been met through a variety of means, including imports from neighboring countries. In 2014, there were more than 3.5 million customers in Iraq, including in the Kurdistan Region. Households represented 82% of these customers, consuming approximately half of all billed electricity. Due to the inadequate supply of electricity, the average Iraqi household received power for only eight hours per day.¹ Peak demand is predicted to rise from around 11 GW in 2015 (Iraq excluding the Kurdistan region) to approximately 32.5 GW by 2030 in the Base Case forecast.² Accordingly, with Iraq's 8% average annual growth of electricity demand, the energy situation will only deteriorate in the future.³

Improving the electricity sector in Iraq is as important and urgent as projects to develop the economy. The Government of Iraq (GoI) recognizes that the current lack of electricity is the main obstacle for investments in all sectors, as electricity is essential to the diversification of Iraq's post-war economy. To this end, the World Bank indicated that the electricity expansion program in Iraq requires an additional US\$83 billion of capital over the period 2011-2030. Further, the World Bank predicts that the electricity sector will require approximately US\$10 billion in the short term for additional power generation and for repairs of existing generators.¹ A sizable p

¹ IFP Grp., *Market Insights, Energy Iraq / Erbil*, <http://goo.gl/Zte11C> (last visited August 30, 2016).

² Parsons Brinckerhoff, *Republic of Iraq, Ministry of Electricity, Iraq and KRG Electricity Master Plans, Final Report, Executive Summary*, vol. 1, 3 (Dec. 2010) (hereinafter, *Iraq Electricity Master Plan*).

³ See World Bank Group, *Republic of Iraq Public Expenditure Review: Toward More Efficient Spending for Better Service Delivery* (2014).

ortion of this US\$10 billion covers recurrent expenditures, mostly salaries, without addressing the need to expand the sector. Additional funding worth US\$5.3 billion from the U.S. Government has been used for 550 energy-related projects since 2003.⁴

As the principal regulator of the electricity sector in Iraq, the MoE has sought to invoke the role of the private sector in several fields such as financing, construction, and contribution in raising the additional generation capacity to cover the country's needs.⁵ Accordingly, power generation in Iraq represents one of the more attractive investment opportunities available to local and foreign investors. The MoE has outlined a series of goals and incentives directed at increasing the sector's capacity by encouraging domestic and foreign investors to build, operate, and supply the country's energy needs. The Iraq Electricity Master Plan and the favorable investment and dispute resolution laws are but a few of the ways in which Iraq has proactively sought to encourage investments and increase the power sector's capacity.

2. THE IRAQ ELECTRICITY MASTER PLAN

The Iraq Electricity Master Plan (excluding the Kurdistan Region) considers the needs and plans for the period 2010 through 2030. The plan outlines: load forecasting, generation, transmission, and distribution planning. The plan was created as a response to the loss of US\$40 billion to Iraq's economy from unserved energy, due to the shortages in electricity supply to the people of Iraq.⁶

The Master Plan's short-term goal called for US\$26 billion to be injected into the power sector. The MoE determined that some of the generation investment could be generated from IPPs, with returns from tariff payments made to IPP owners.

a. Load Forecasting

In 2009, the MoE, in partnership with Parsons Brinckerhoff, analyzed the substations and electrical systems throughout the country. From this data, it was estimated that there was a dispatched generation demand of approximately 13.4 GW. The MoE also calculated that Iraq would have an average of 7% growth in their real GDP. The report forecasted that the base case load in 2030 would be an average of 32.5 GW. Approximately 56% of this demand would be used for domestic usage, while the remaining would be channeled for commercial, industrial, and agricultural purposes.

b. Generation Planning

In 2009, estimates found that Iraq had 115 billion barrels of crude oil resources and 112 trillion cubic feet of natural gas reserves, with 70% of the gas reserves located in the Basrah governorate. The increased usage of natural gas in Iraq can be traced to the implementation gas-fired gas turbines (GTs) and combined-cycle gas turbines. As Iraq moves away from crude oil, gasoil, and heavy fuel oil, natural gas has become the economic and environmental fuel of choice. Furthermore, the conversion of

⁴ See *id.* at 86.

⁵ Republic of Iraq, Nat'l Inv. Comm'n, *Iraqi Investment Map 2016*, available at http://investpromo.gov.iq/nic_flash/reference_materials/investment_map_english/.

⁶ See *Iraq Electricity Master Plan*, *supra* note 3.

power stations running on crude oil and GTs operating on heavy fuel oil to gas is a main priority in Iraq's power sector strategy. The transition is driven by the high relative value of oil-based fuels for export and the subsequent competitive advantage of natural gas in Iraq. Further, conversion of GTs running on gas to combined cycle operation, in addition to incorporating new combined cycle plants, would be the most optimum approach to a revised power sector strategy.⁷

The efficiency and high generation potential of conversion will enable a reduction of existing power station sites.⁸ In the generation planning analysis, the Master Plan noted that the capacity of existing plants would decrease from 9.2 GW in 2009 to 3.5 GW in 2030 due to the retirement schedule for the plants, which was based on their condition and on the dates of commission and rehabilitation. However, the analysis also noted that there were already about 11 GW of committed generation capacity from GE, Siemens, and Hyundai in the form of gas turbines. These gas turbines would become part of a MegaDeal and subsequently converted to combined cycle. In 2016, GE signed a "Power Up" plan with the MoE for US\$328 million to provide equipment and maintenance for 10 plants, increasing the electricity production capacity by one GW.⁹

c. Short-Term Transmission Planning

The existing Iraqi transmission network uses 400 kV and 132 kV, as shown in the map below. The map also indicates the locations of the Grid Supply Points (GSPs), Bulk Supply Points (BSPs) and the major load centers in the country. The 132 kV network is the local load distribution network within each governorate, with a few 132 kV ties to neighboring governorates, while the 400 kV network is the national grid bulk power transfer highway between the governorates and with neighboring countries. The network consists of:

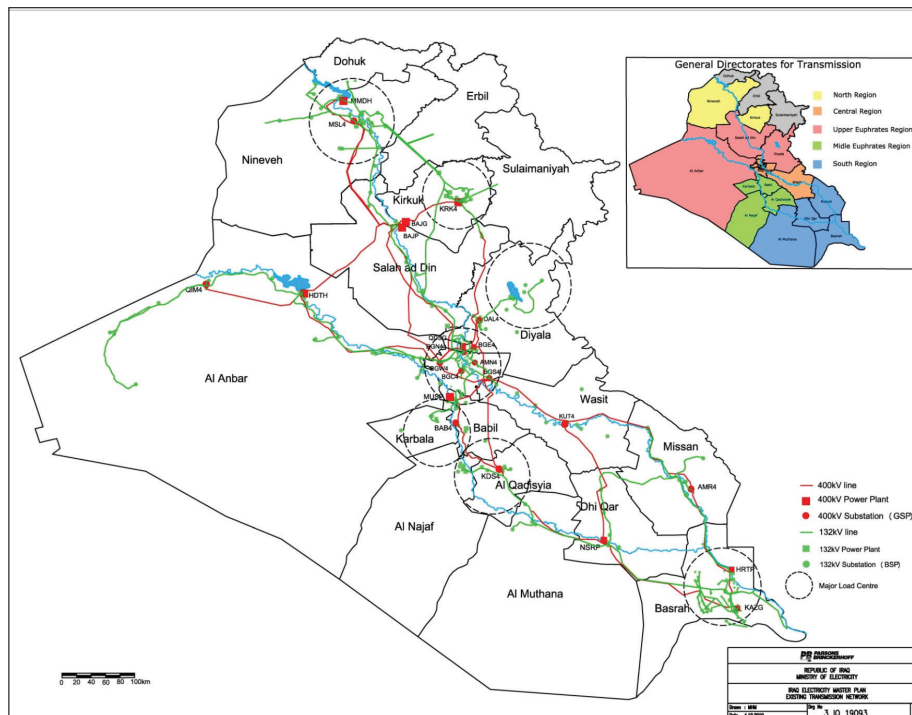
- 3723km of 400 kV, twin 490/65mm² ACSR, single circuit construction overhead lines with thermal rating of 100MVA;
- 24 400/132 kV substations (GSPs);
- 13,746km of 132 kV overhead lines; and
- 209 132/33/11kV substations which are used as BSPs to distribute electricity in the governorates.

The major problem with the existing system is the high fault levels on the 132kV system, particularly in Baghdad. Seventeen percent of the BSPs in Iraq have three phase fault levels higher than 30kA, and all these BSPs are located in Baghdad city.

⁷ See *Iraq Electricity Master Plan*, *supra* note 3.

⁸ See *id.*

⁹ See Ahmed Rasheed, *Iraq agrees \$328 million GE deal to boost electricity grid*, *Reuters* (Jan. 25, 2016, 7:41 AM), <http://www.reuters.com/article/us-iraq-energy-idUSKCN0V31B5>. See the "Success Stories" section below for further details about the GE MegaDeal.



d. Long-Term Transmission Planning / Pipelines

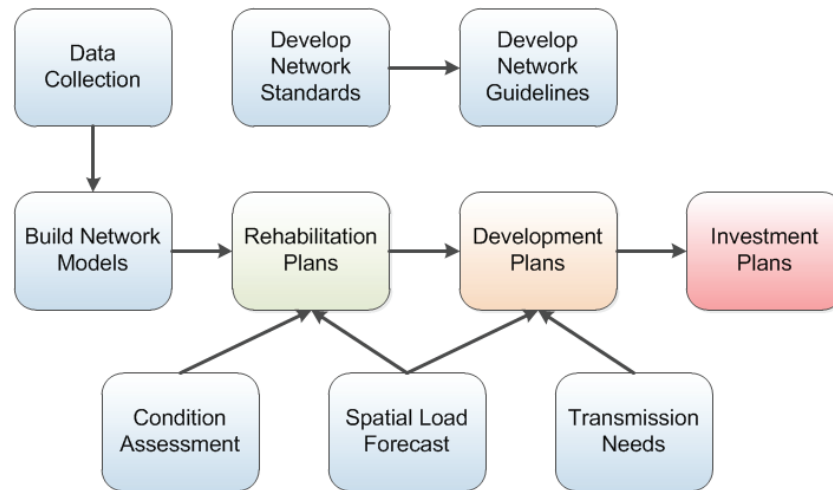
The Ministry of Oil (MoO) released information indicating that over 50% of gas resources will come from the Southern region of Iraq (Basrah/Missan/Thiqr). An electricity demand forecast showed that Baghdad accounts for 35% of the demand in Iraq, while Basrah accounts for about 15% of the demand. Utilizing this information, the Master Plan then addressed the question of whether the generation plants should be built in the Southern region and transmitted to Baghdad or if the generation plants should be constructed around Baghdad, transferring gas through underground pipelines.

The MoO had envisioned several key pipelines to be built across various provinces in Iraq between 2010 through 2015. These included the following: 2009 pipeline traveling between Basrah, Thiqr, Muthana, Qadisiya, Babil, and Baghdad; 2011 pipeline between Basrah, Muthana, Najaf, Karbala, and Al-Anbar; and two pipelines in 2015 between Basrah, Missan, Wasit, and Diyala, and Basrah, Thiqr, Muthana, Qadisiya, Babil, and Baghdad. The rise in terrorist activity in Iraq and the fall in global oil prices have significantly slowed the MoO's pace in achieving its construction objectives.

Taking all of this into consideration, the Master Plan concluded that it would be less costly to generate electrical power where gas resources are located and transmit the power to cities such as Baghdad.

e. Distribution Planning

Distribution planning in Iraq is a complex, resource-intensive process that requires deep knowledge of local conditions, loads, and future growth. The MoE's distribution planning, as outlined in the Master Plan, is illustrated in the figure below:



The poor condition of Iraq's distribution network is currently negatively impacting the quality and efficiency of power supply, which is experiencing a high level of losses. The Master Plan concluded that an immediate reduction of losses at the distribution level is crucial to ensure the correction of maintenance and construction problems. The Master Plan also recommended the immediate establishment of a Loss Reduction Program.

3. SOVEREIGN GUARANTEES

Iraq's current credit rating is a B- (S&P 2016). The security, political, economic, regulatory, and legal environments in Iraq today do not provide the confidence investors and lenders will need to fund capital intensive assets such as power plants. Sovereign guarantees have been widely used in developing regions such as countries in Africa and Asia, including Kenya, Morocco, Nigeria, and Indonesia, to fund infrastructure, power plants, and other public service projects. As discussed further in Chapter III of this Legal Guide, the Iraqi MoF may provide sovereign guarantees for certain power projects.

4. THE PRIVATE GENERATORS MARKET

A large population of Iraq currently pays two electrical bills, one to the government and the other to the owners of private generators. Indeed, approximately 90% of Iraqi households supplement the public network with private generators. In 2011, generation from private generators was estimated to be three terawatt-hours, while 37 terawatts came from the power grid. Private generators currently play a major role in making up for the shortfall from government supply of electricity.¹⁰ Although

¹⁰ See *Iraq Electricity Master Plan*, *supra* note 3.

private generators receive subsidized fuel from the government, the price to consumers is anywhere between 10-15 times more than grid electricity. However, even with these two forms of electricity output, the average availability of electricity to consumers in 2011 was limited to around 11 to 19 hours per day.¹¹

5. THE LEGAL FRAMEWORK AS IT PERTAINS TO THE POWER SECTOR

Beyond addressing the immediate need to add capacity to the network, efforts have been under way in Iraq to put the electricity sector on a legal and regulatory footing that will facilitate its development over the coming decades.¹²

C. REGULATORY AGENCIES IN THE POWER SECTOR

In addition to the role of the MoF and Council of Representatives in issuing sovereign guarantees to support power sector projects, the following are also key GoI institutions that play a critical role in the power generation process:

1. THE MINISTRY OF ELECTRICITY

The MoE is headquartered in Baghdad, Iraq, in the Al-Mansour District. The power sector is primarily regulated and managed by the MoE. Further, the MoE manages the generation, load dispatch and distribution of the power sector, except in the Kurdish Region, which is managed by the Kurdish Regional Government's MoE. Historically, there has not been grid connectivity between the federal network and the KRG network. Both ministries ensure parallel operations, which cover separate geographic regions. The MoE is responsible for policy setting, regulations, planning, engineering and projects, and the operation of electrical assets. The MoE is also responsible for suggesting tariff levels, which must then be approved by the Council of Representatives. Lastly, the MoE determines Iraq's power sector investment needs and either enters into direct negotiations or issues a request for proposals in connection with a proposed project.

2. THE MINISTRY OF OIL

The MoO is responsible for Iraq's oil and gas industry including encouraging investments, operation of infrastructure, planning, recommending and overseeing energy related policies. The MoO operates and manages 16 state-owned oil companies and five training centers or institutes focused on the oil and gas industry. In the context of power generation, the MoO is required to provide 100% of the feedstock necessary to operate an independent power producer. Any deficiencies in supply are the responsibility of the MoE (hence, the Iraqi Power Purchase Agreement is structured as an energy conversion agreement). It is worth noting that the importance of oil is not limited to its role in developing Iraq's economy; rather, it also functions to allow Iraq to respond to the demand from the power sector.

¹¹ See *Int'l Energy Agency, World Energy Outlook Special Report: Iraq Energy Outlook 31 (2012)*.

¹² For further information, see "Fiscal Policies and Provisions in the Power Sector" section below.

3. THE GENERAL COMMISSION FOR TAXES

The General Commission for Taxes (GCT) was established in 1982, pursuant to Act No. 92 of 1981 and is a body that falls under the MoF. The main objectives of the GCT are to generate revenues that contribute to the State budget and to create better tax laws. The GCT sets tax rates and laws, as well as passes tax incentives to encourage foreign and Iraqi investors to invest capital. The corporate income tax rate has remained stagnant at a rate of 15% for several years, similar to the long-term capital gain tax rates in the United States.

It is worth noting that under the Investment Law No. 13 of 2006, projects are exempt from taxation for 10 years and the NIC has the right to increase the exemption, as discussed below in Chapter II.G. (*Applicable Incentives for IPPs*) of this Legal Guide.

4. NATIONAL INVESTMENT COMMISSION

Under Investment Law No. 13 of 2006 (the National Investment Law),¹³ the GoI laid out the foundation to attract foreign direct investments into Iraq. The National Investment Law provided for several strategic initiatives including tax incentives, investor guarantees, and obligations of investors. The National Investment Law also established the National Investment Commission (NIC), making it responsible for all national policies for investment and to serve as promoter, facilitator, monitor, and policy advisor for investments in Iraq. The NIC specializes in strategic investment projects of a federal nature exclusively and monitors the implementation of guidelines and instructions in investment.

The NIC has full access to national-level bodies including parliament, ministries, and the Prime Minister's office. To facilitate investment in Iraq, Investment Law No. 13 called for the creation of a One-Stop-Shop, a single interface for investors looking to bring their business to Iraq. By streamlining many of the legal and regulatory requirements facing investors, the NIC hopes to simplify the investment process for international investors in Iraq.¹⁴

Through Provincial Investment Commissions (PICs), which were established under Investment Law No. 13 of 2006,¹⁵ the NIC can support the needs and priorities of each of Iraq's provinces. PICs consult with local governments regarding investment plans and facilities and coordinate their activities with the NIC on drafting investment policies. These PIC offices also draw investment maps of their respective provinces and grant investment licenses for non-strategic projects under US\$250 million.

Under Investment Regulation No. 2 for 2009, the NIC has exclusive jurisdiction over electric power projects with production capacity not less than 30 MW.¹⁶ In

¹³ See *Investment Law No. 13 of 2006 art. 4 (Iraq)*.

¹⁴ See Commercial Law Dev. Program, *Legal Guide to Investment in Iraq 29 (2016)*, available at [http://cldp.doc.gov/sites/default/files/Legal%20Guide%20to%20Investment%20in%20Iraq%20\(2016\).pdf](http://cldp.doc.gov/sites/default/files/Legal%20Guide%20to%20Investment%20in%20Iraq%20(2016).pdf).

¹⁵ See *id.*, art. 5.

¹⁶ See *Investment Regulation No. 2 for 2009, art. 4 second (h) (Iraq)*.

coordination with the MoE, the Board of Directors for the NIC prepares an investment map for investment projects and investment opportunities.¹⁷

5. SOVEREIGN IMMUNITY

The MoE and other Iraqi government counterparties can waive sovereign immunity in theory, but for political and optics reasons refer to this as a waiver of “judicial” immunity (a dispute resolution clause functions as a de facto waiver) and will be resistant to using the term “sovereign” immunity.

Below is a standard waiver of judicial immunity clause:

“The First Party agrees that it will not invoke its judicial immunity against the Second Party in pursuing its right to seek arbitration and shall waive any motion or objection relating to such immunity. The First Party agrees to the jurisdiction of the arbitration board provided in Section [XX] of this Contract in case any Dispute arose regarding the interpretation or execution of this Contract, as well as any decisions issued by the arbitration board regarding this Contract.”

D. KEY INTERNATIONAL INSTITUTIONS

International support for Iraq reconstruction includes bilateral and multilateral assistance that has come in the forms of loans and grants. Below are descriptions of Development Financial Institutions and Export Credit Agencies that have financed or guaranteed a deal in Iraq. Examples are given of the participation and general details behind some of the projects that have taken place in Iraq. The institutions that have made a significant impact in Iraq are not limited to the institutions listed herein and the example projects do not constitute a complete list of all projects that have taken place in Iraq’s power sector.

1. INTERNATIONAL FINANCE CORPORATION (IFC)

IFC is a member of the World Bank Group that finances and provides advice for private sector ventures in developing countries.

In Iraq, IFC focuses on aiding in the development of the private sector. IFC expects to invest US\$100-130 million over the next few years in Iraq, focusing on infrastructure financial markets. Additionally, on April 28, 2016, IFC announced that it was committing US\$375 million in financing for an Iraqi power company, Mass Global Holdings Sulaymaniyah, to provide an additional 500 MW of capacity to a 1,000 MW power plant in Kurdistan, thereby providing power to three million people. Mass Global Holdings will also help complete a new power plant near Baghdad that will supply the city’s electricity requirements.¹⁸ Another example of IFC’s role in Iraq’s power sector is their financing of the Zakho Power Plant (see Chapter II.D.2 (*Multilateral Investment Guarantee Agency (MIGA)*))

¹⁷ See Tom Arnold, *IFC arranges \$375 mln in financing to boost Iraq’s power sector*, Reuters (Apr. 28, 2016, 4:30 AM), <http://www.reuters.com/article/ffc-iraq-power-idUSL5N175RY>.

¹⁸ See Reuters, *IFC arranges \$375 mln in financing to boost Iraq’s power sector*.

and Chapter II.K (*Iraq Power Generation Success Stories*) below for more information regarding the completion of the Zakho Power Plant).¹⁹

2. MULTILATERAL INVESTMENT GUARANTEE AGENCY (MIGA)

MIGA is a member of the World Bank Group that promotes foreign direct investment into developing countries to support economic growth. MIGA attracts investors and private insurers to demanding and challenging environments by insuring these investments. One of MIGA's target areas is energy efficiency in countries eligible for assistance from the International Development Association (IDA). MIGA provides political risk insurance guarantees to private sector investors and lenders. These guarantees generally protect investments against non-commercial risks and assist investors in obtaining access to funding sources with improved financial terms and conditions, given the support of the MIGA guarantee.²⁰

In general, MIGA insures eligible projects against losses resulting from currency inconvertibility, expropriation, war, terrorism, breach of contract, and non-honoring of financial obligations. Such coverage may be purchased from MIGA individually or in combination.²¹ The insurance benefits investors and lenders by:

- Providing additional leverage in protecting investments through the relationship with the shareholder governments;
- Resolving disputes by intervening at times of conflict or disagreement and attempts to resolve the disputes before they reach claim status. If MIGA is unable to resolve the dispute, its strong financial status allows MIGA to make payments if the claim is enforced;
- Assisting investors to obtain project financing from banks and equity partners;
- Lowering borrowing costs; and
- Increasing the tenor of loans available to investors.

In March 2015, MIGA proposed a guarantee that would cover loans from financial institutions that were determined in UNIT Zakho Power Plant in Iraq. The financing was covered by a MIGA guarantee for up to US\$400 million for a period of up to 13 years against the risks of transfer restriction, expropriation, war and civil disturbance, and breach of contract. This project involved the development and design through to the construction, testing, and operation of a gas-fired power plant with a capacity of 840 MW in the Kurdistan Region.²² This project was rated by MIGA as a category A project, because it may have potentially significant adverse social or environmental impacts that are diverse, irreversible, or unprecedented.²³

¹⁹ See "Success Stories" below regarding IFC role in funding the Zakho Power Plant.

²⁰ Multilateral Inv. Guar. Agency, *Investment Guarantee Guide (July 2015)*, available at <https://www.miga.org/documents/IGEnglish.pdf>.

²¹ Multilateral Inv. Guar. Agency, *Types of Coverage*, <https://www.miga.org/Pages/Investment%20Guarantees/Overview/TypesOfCoverage.aspx#toc5>.

²² Multilateral Inv. Guar. Agency, *Summary of Proposed Guarantee*, <https://www.miga.org/pages/projects/project.aspx?pid=1410>.

²³ Multilateral Inv. Guar. Agency, *Environmental and Social Sustainability*, <https://www.miga.org/projects/environmental-and-social-sustainability>. See *Success Stories* in Chapter II below for more information regarding the completion of the Zakho Power Plant.

3. WORLD BANK IRAQ TRUST FUND

The World Bank Iraq Trust Fund commits funds to the International Reconstruction Fund Facility for Iraq for the financing of projects. The World Bank also commits funds through the IDA.

4. UNITED NATIONS DEVELOPMENT PROGRAMME IRAQ (UNDP)

The UNDP provides the MoE in Kurdistan with technical assistance and grants financial assistance to electricity rehabilitation. In 1997, the UNDP implemented the Electricity Network Rehabilitation Programme to rehabilitate the electricity network across four sectors in the northern governorates of Erbil, Dahuk, and Sulaymaniyah.

5. JAPAN BANK FOR INTERNATIONAL COOPERATION (JBIC) AND JAPAN INTERNATIONAL COOPERATION AGENCY (JICA)

JICA and JBIC have been providing loans and assistance to Iraq and aiding in the redevelopment of their infrastructure for several years. JICA's support to Iraq is primarily focused on (i) the promotion and diversification of industry for economic growth, (ii) strengthening the basic economic infrastructure, and (iii) building a foundation for the livelihoods of the people.²⁴

Official Development Assistance (ODA), with concessional terms and a grant element of at least 25%, must be undertaken by governments for the promotion of economic development and welfare in developing countries.²⁵ In an effort to improve Iraq's situation, JBIC signed a deal in 2008 supporting the Al-Mussaib Thermal Power Plant Rehabilitation Project and the Electricity Sector Reconstruction Project. The objective of the project was to expand the power generation capacity by rehabilitating Al-Mussaib Thermal Power Plant. Another objective of the Electricity Sector Reconstruction Project in Kurdistan Region was to improve the levels of reliability and availability of the electricity network in the Kurdistan Region by developing substations and distribution sectors.

6. THE EXPORT-IMPORT BANK OF KOREA AND SOUTH KOREAN PROJECTS IN IRAQ

The Export-Import Bank of Korea, also known as Korea Eximbank (KEXIM) is the official export credit agency of South Korea.²⁶ The primary purpose of KEXIM is to support South Korea's economy by providing loans, financing mega projects, and facilitating economic cooperation with other countries. KEXIM provides financial support for overseas investment projects and the development of overseas natural resources.²⁷

²⁴ Japan Int'l Cooperation Agency, *Iraq*, <http://www.jica.go.jp/iraq/english/>.

²⁵ Japan Int'l Cooperation Agency, *Japan's ODA and JICA*, <http://www.jica.go.jp/english/about/oda/index.html>.

²⁶ *Company Overview of The Export-Import Bank of Korea*, Bloomberg (Aug. 30, 2016, 4:03 PM), <http://www.bloomberg.com/research/stocks/private/snapshot.asp?privcapId=3590645>.

²⁷ Export-Import Bank of Korea, *Purpose of Establishment*, Korea Eximbank, <https://www.koreaexim.go.kr/site/homepage/menu/viewMenu?menuId=002001001001>.

KEXIM has provided billions of dollars to the development and reconstruction of Iraq. On July 11, 2012, KEXIM announced that it planned to provide US\$1.16 billion in guarantees to Hanwha Engineering and Construction for the Bismayah New City Project in Iraq. The guarantee is comprised of a US\$775 million advance payment bond and a US\$338 million performance bond. The advance payment bond guaranteed the liability of Hanwha to repay advance payments received for initiating construction and the performance bond guaranteed the liability of Hanwha for failing to execute the terms of the contract between themselves and the sponsor. Hanwha is to build a new city accommodating 100,000 households in Bismayah over a seven-year period. The total project will cost approximately US\$7.75 billion.²⁸ Further, Hanwha won an additional US\$2.12 billion contract to build the social infrastructure for Bismayah New City. The subsequent agreement was signed on December 2015.²⁹

KEXIM also announced on September 16, 2013 that it planned to provide US\$117 million in guarantees to Daewoo Engineering and Construction for the Akkas Gas Field Project in Iraq. The guarantee is comprised of a US\$46 million advance payment and a US\$71 million performance bond.³⁰

7. OVERSEAS PRIVATE INVESTMENT CORPORATION (OPIC)

OPIC provides financial products such as loans and guaranties, political risk insurance, and support for investment funds, so long as the transaction furthers OPIC's development mission and involves significant U.S. involvement (typically, at least 25% U.S. ultimate beneficial ownership of the project company). For example, in 2013, OPIC provided political risk insurance to Ellicott Dredges LLC to support the sale of its dredging equipment to the Iraqi MoE. OPIC's proposed insurance amount was US\$505,000 and the total project costs were estimated at US\$11 million.

8. OTHER INSTITUTIONS

The list of institutions above is not exhaustive, nor does it cover all projects. There are other Development Financial Institutions, including but not limited to the Islamic Development Bank, the European Bank for Reconstruction and Development (EBRD), European Investment Bank (EIB), Kuwait Fund for Arab Development (KFAED), and OPEC Fund for Development (OFID). Further, there are other export credit agencies, including but not limited to US ExIm, NEXI, K-SURE, China Export & Credit Insurance Corporation (Sinosure), and European ECAS such as SACE, CESCE, COFACE, and UKEF. Local and regional banks, as well as international banks, contribute to Iraq's power sector. These include Trade Bank of Iraq (TBI), Bank of Baghdad, Rafidain Bank, National Bank of Iraq, Citi, J.P. Morgan, HSBC, SMBC, BTMU, China Construction Bank, and Bank of China.

²⁸ *USD 1.16 Billion Guarantee Provided for Iraq's New City Project*, Korea Eximbank, <https://koreaexim.go.kr/site/program/board/basicboard/view?&boardtypeid=284¤tpage=49&menuid=016004007%2C016004007&pagesize=10&boardid=16750>.

²⁹ *Hanwha Wins Addition \$2.12 Billion Construction Project in Iraq, Totaling over \$10 Billion in the Bismayah New City Alone*, Hanwha (Apr. 6, 2015), http://www.hanwha.com/en/news_and_media/press_release/hanwha_wins_additional_2_12_billion_dollar_construction_project_in_iraq_totaling_over_10_billion_dollar_in_the_bismayah_new_city_alone.html.

³⁰ *USD 117 Million Guarantee Provided for Iraq's Akkas Gas Field Project*, Korea Eximbank, <https://koreaexim.go.kr/site/program/board/basicboard/view?&boardtypeid=284¤tpage=17&menuid=014003007%2C014003007&pagesize=10&boardid=16914>.

E. THIRD COUNTRIES

1. IRAN

Iran supports Iraq's power sector by providing gas through pipelines that travel from Iran to multiple power plants in Iraq. For example, in 2013, Iran and Iraq signed an agreement whereby Iran would export gas from the South Pars field. In April 2016, Iran completed 100km of pipelines on the Iranian side that will be connected to Iraq to complete a 270 km network. Based on this agreement, 25 MCM of gas will be delivered daily to Sadr, Baghdad and Al-Mansouryah power plants, earning Iran US\$3.6 billion a year in revenue.

F. LAND RIGHTS IN IRAQ

1. CONSTITUTIONAL BASIS OF LAND RIGHTS

Sharia has separated land into a few categories: privately-owned land (*mulk*), land in charitable trusts (*waqf*), publicly owned land (*matrukah*), unused land (*mawat*), and state-owned land possessed by an individual (*amiri*).³¹ *Amiri* land can be possessed by an individual who retains *tasarruf* rights. *Tasarruf* is the "right to use, exploit, and dispose of *amiri* land."³²

The Iraqi Civil Code of 1951 regulates property rights such as *tasarruf*. A possessor of *miri* land is entitled to *tasarruf* rights. *Tasarruf* can be used as security for a loan. Under Article 1233 of the Iraqi Civil Code, a holder of a *tasarruf* forfeits the right to the land if the holder does not exploit it and leaves it unused for three years without cause.³³

Iraq's Constitution, approved on October 15, 2005, seeks to protect private property and affords investors land rights. Under Article 23, the Constitution protects private property, giving the owner the right to benefit, exploit, and dispose of private property. The Constitution holds that every Iraqi has the right to own property anywhere in Iraq and no others may possess immovable assets, except as exempted by law.³⁴ This has been amended by Investment Law No. 13, affording foreign investors the same rights and privileges as Iraqi nationals (discussed in greater detail below).

Expropriation is always a major concern for foreign investors. However, Iraqi law has expressly prohibited expropriation without just compensation. Article 23 of the Constitution, designed to protect the rights of *tasarruf* holders, prohibits expropriation unless the landowner is provided with just compensation and such expropriation is for the benefit of the public (eminent domain). While the specific

³¹ Farhat J Ziadeh, *Property Law in the Arab World: Real Rights in Egypt, Iraq, Jordan, Lebanon, Libya, Saudi Arabia, and the Gulf States* 8 (1979).

³² See also, Chapter III of Land Registration Act No. 43 of 1971, as amended.

³³ See Iraqi Civil Code of 1951, art. 1233. Further, Article 1175 of the Iraqi Civil Code states, in pertinent part, "no person may exploit an *amiri* land to which a third party has a right of disposal (*tasarruf*)." Article 1176 states, in pertinent part, "where a person has usurped an *amiri* land (state owned property), the person who is entitled to dispose (the holder of a *tasarruf* right), may recover it from him and may claim the comparable rent." Article 1178 states that "the person who has the right to dispose (*tasarruf* holder) of an *amiri* land, may not be deprived of his said right except in the cases and in the manner prescribed in the law which he will receive a fair compensation in advance for."

³⁴ Article 23, Doustour Joumhouriat al-Iraq [The Constitution of the Republic of Iraq] of 2005.

expropriation legislation envisioned in the Constitution has yet to be ratified, the National Investment Law provides a guarantee against the seizure or nationalization of investment projects, excepting final judgments issued by Iraq's Commercial Court, which resolves all expropriation cases.

2. EXTENDING LAND RIGHTS TO FOREIGN INVESTORS

Investment Law No. 13 of 2006 was legislated in an effort by the Iraqi Government to attract private and foreign investment to Iraq. The National Investment Law specifies which lands are owned by the state and restricts their use, placing them at the disposal of the NIC for the purpose of allocating them for investment projects. The National Investment Law extends to all sectors, except for investments in the production and extraction of oil and natural gas and investments in the banking and insurance sector. The minimum capital of the project being covered by the provisions is set at US\$250,000 or its equivalent in Iraqi dinars. The National Investment Law holds that Iraqi and foreign investors will enjoy the same privileges, facilities, and guarantees (Article 10/A of Investment Law No. 13 of 2006).

3. OWNING AND LEASING LAND

There are two important sources of Iraqi investment legislation that provide guidelines for the owning and leasing of lands by potential Iraqi or foreign investors:

- Investment Law No. 13 of 2006, which provides that Iraqi and foreign investors may own publicly owned land for housing;³⁵ and
- Regulation No.5 (2011), which outlines “The Sale and Leasing of Real Estate and Landed Property belonging to the State and Public Sector for Investment Purposes.” This regulates how rent is assessed in specified investments when leasing or buying public real estate.

a. *Owning Land*

Under Regulation No. 5 of 2011, the value of land and property, owned by departments of the state and other Iraqi government bodies, for the purposes of investment projects, except housing projects, shall be assessed by committees formed as follows:³⁶

- For investment projects of value exceeding US\$250 million, committees shall be formed by the NIC and PICs as follows:
 - » Chairman of the NIC, president
 - » Head of the investment commission of the concerned governorate, member
 - » Director General of General Tax Authority, member
 - » Director General of Real Estate Registration Department, member
 - » Representative of the authority that owns the real estate or land property, member.

³⁵ Investment Law No. 13 of 2006, art. 10/Second/A/1 and 2 (Iraq).

³⁶ See Regulation No. 7 of 2010, art. 4 and 5 (Iraq).

- For investment projects of value below US\$250 million, committees shall be formed by the National Investment Commission as follows:
 - » Head of the investment commission of the concerned governorate, president
 - » Representative from the National Investment Commission, member
 - » Representative of the General Tax Authority in the governorate, member
 - » Representative of the Real Estate Registration Department in the governorate, member
 - » Representative of the authority that owns the real estate or land property, member.
- The investor must abide by the purpose for which the land or property ownership was allocated under the investment license or risk cancellation of the registration by the Real Estate Registration Administration, resulting in the return of the land/property to its former owner at the request of the NIC or the PIC issuing the license.³⁷
- The developer may assign partial or full ownership of a project under the Investment Law to a developer only after completion of 40% of the project and with the approval of the NIC.

b. Leasing Land

To establish an investment project, the investor may lease land and real estate from the government, private owners, or mixed sectors for a term of not more than 50 years. This lease period is renewable upon consent of the parties and after full consideration of the nature of the project and its economic feasibility.³⁸

Articles 8 and 9 of Regulation No. 7 of 2010 explain the leasing process whereby the NIC leases the land for the purpose of executing industrial, agricultural, service, recreational, and other investment projects, beginning on the date that commercial operations commence. Electrical power and oil projects are located outside municipal borders and are carried out in the form of build, operate, and either own or transfer to the beneficiary provide, own and build, operate, transfer to the beneficiary provide a leasing return of 2% of the estimated annual lease return.³⁹

4. OTHER RELEVANT PROPERTY LAWS

The following are exclusions for real estate allocated for the establishment of investment projects and other laws relevant to property:⁴⁰

- Under the Real Estate Rental Tax 162 of 1959, a basic tax is assessed and collected that is equivalent to 10% of the annual revenue from all real estate. However, the annual revenue is discounted by 10% for real estate maintenance and expenses. An additional tax is assessed and collected if the revenue of the real estate exceeds 750,000 Iraqi dinars, according to the schedule in Article

³⁷ Investment Law No. 13 of 2006, art. 10/Second/E (Iraq); Regulation No. 5 of 2011, art. 6/Third (Iraq).

³⁸ Investment Law No. 13 of 2006, art. 10/Third/A (Iraq).

³⁹ See Regulation No. 7 of 2010, art. 8 (Iraq). For further information regarding leasing land, see *Legal Guide to Investment in Iraq*, *supra* note 14, at 33-5.

⁴⁰ For general laws regarding leasing and owning land, see *Legal Guide to Investment in Iraq*, *supra* note 14.

2.⁴¹ Further, several exemptions are provided under Article 3.

- The Sale and Lease of Government Assets Law No. 21 of 2013 states that the basis of calculating the sale and rent amounts shall be determined in accordance with the regulations to be issued for this purpose.

G. APPLICABLE INCENTIVES FOR IPFS

The incentives and privileges a foreign investor would be guaranteed are provided in:

- Chapter Three of the Investment Law No. 13 of 2006, which outlines privileges and guarantees;⁴²
- Chapter Five of the Investment Law, which outlines tax and customs duties exemptions;⁴³ and
- Decree No. 170 of 1983 and the Tax Free Zone created by the Iraq General Commission for Taxes.

1. GUARANTEES AND PRIVILEGES

There are a number of guarantees and privileges afforded to eligible foreign investors:

- The National Investment Law grants foreign investors the right to repatriate the capital brought into Iraq as well as its proceeds, pursuant to the instructions of the Central Bank of Iraq, in an exchangeable currency and after paying all taxes and debts to the Iraq government and all other authorities;⁴⁴
- Foreign investors shall be afforded the right to deal in the Iraq Stock Exchange (ISX), rent or lease lands needed for the project for the term of the investment project, provided that the rent or lease cannot be renewed for more than 50 years except with agreement of the Commission;⁴⁵
- The National Investment Law grants foreign investors the right to open a branch of the foreign company;⁴⁶
- Through Article 12/Third, the Investment Law guarantees foreign investors the right of ownership and protection against seizure or nationalization of the investment project, except in the case of a final court decision and the investment project shall not be expropriated except for public benefit, in whole or in part, and under just compensation. Protection against seizure and nationalization of all or any part of the relevant project (except for public benefit) is provided in exchange for fair and just compensation;
- Foreign investors may hire foreign workers as needed, but priority must be given to Iraqi workers.⁴⁷ Further, non-Iraqi technicians and administration employees working for investment projects may transfer their salaries and other compensation out of Iraq after paying all taxes and debts owed to the GoI and all other authorities;⁴⁸

⁴¹ Real Estate Rental Tax 162 of 1959, art. 2 (Iraq).

⁴² See *Investment Law No. 13 of 2006, art. 3 (Iraq)*.

⁴³ See *id.* at art. 15 – 18.

⁴⁴ See *id.* at art. 11/First.

⁴⁵ See *id.* at art. 11/Second/A.

⁴⁶ See *id.* at art. 11/Second/C.

⁴⁷ See *Investment Law No. 13 of 2006, art. 12/First (Iraq)*.

⁴⁸ See *id.* at art. 12/Fourth.

- Foreign investors have the right to insure the investment project with any foreign or national insurance company they deem suitable;⁴⁹
- Foreign investors have the right to “open accounts in Iraqi or foreign currency or both at a bank inside or outside Iraq for the licensed project”;⁵⁰
- The provisions of Investment Law No. 13 of 2006 shall apply to mixed sector projects and existing or operating private sector projects at the request of management and the approval of the Commission, without retroactive effect;⁵¹
- The National Investment Law applies to partnership projects between the public and the private sectors, including public sector projects contracted for rehabilitation or operation or to be established with both private and mixed sector provisions of this law before and after the entry into force of this law and may not be exempt from state taxes and fee exemptions owed prior to its enforcement;⁵² and
- The Council of Ministers can replace lands and facilities belonging to the public sector in exchange for constructing new facilities with modern production lines with the exception of relevant legislation in accordance with the instructions issued by the Council of Ministers.⁵³

2. TAX AND CUSTOMS INCENTIVES AND EXEMPTIONS

a. Tax and Customs Incentives

Eligible investment projects are exempt from taxes and fees for a period of 10 years from the date of commencement of commercial operations, in accordance with the areas and development defined by the Council of Ministers at the suggestion of the NIC based on the degree of economic development and the nature of the investment project. This tax-exempt period restarts if the MW level of the project increases.⁵⁴ Furthermore, the NIC has the right to increase the years of tax and fees exemption in a way directly proportional to the increase in the Iraqi Investor share in the project to reach a maximum of 15 years if the Iraqi Investor share in the project is more than 50%.⁵⁵ In addition, assets imported for the purposes of the investment project shall be exempted from taxes and customs duties.⁵⁶

In terms of raw materials, those imported for the purposes of commercial operation of the project that are used to manufacture ration card items, medicines, and construction materials shall be exempted from taxes and customs duties, with the exception of raw materials available and produced in Iraq. Furthermore, raw materials imported for the purposes of commercial operation of the project shall be exempted from taxes and customs duties in accordance with the proportions of local materials contribution to the manufacture of the product, to be determined under controls developed by the NIC in coordination with the sectoral authorities.⁵⁷

⁴⁹ See *id.* at art. 11/Fourth.

⁵⁰ See *id.*

⁵¹ See *id.* at art. 32/A.

⁵² See Investment Law No. 13 of 2006, art. 32/B (Iraq).

⁵³ See *id.* at 32/C.

⁵⁴ See *id.* at art. 15/First/A.

⁵⁵ See *id.* at art. 15/Third.

⁵⁶ See *id.* at art. 17.

⁵⁷ See *id.* at art. 17/Fifth/B.

Imported spare parts are exempted from fees if the value of these parts does not exceed 20% of the fixed assets value, provided that they are not to be used for any other purpose.⁵⁸ Also, under Article 30 of Investment Regulation No. 2 of 2009, the investment project must utilize local materials and satisfy the potential local demand for the project's product in order to benefit from the taxes and import duties exemptions as determined by Investment Law No. 13 of 2006.

3. FREE ZONES

Iraq has created "Free Zones" to advance the economy and to create new opportunities for local workers and reduce unemployment. The Free Zones were also created to increase the volume of exports and income of foreign currency by establishing different investment projects. The Free Zones Law No. 3 of 1998 established the General Commission for Free Zones under the MoF.⁵⁹

- **Locations of Free Zones:**
 - » There are currently three Free Zones: (1) Nineveh, (2) Khor Al-Zubair/Basrah and (3) Al-Qa'im/Anbar.
- **Permitted activities in the Free Zones:**
 - » The Free Zones Law allows industrial, commercial, and service projects investment in specific zones designated as "Free Zones" to benefit from many exemptions. Activities such as industries that pollute the environment, involve toxic materials, or are harmful to public health, are prohibited. To apply for approval to begin a project in a Free Zone, investors must submit a request and pay a US\$100 USD fee to the Free Zones Board.
- **The Free Zones Law enables the following activities in Free Zones:**
 - » Industrial activities, including production, sales, assembly, manufacturing, and repacking;
 - » Warehousing for re-export and trade;
 - » Warehousing services;
 - » Transportation services;
 - » Banking, insurance, and reinsurance; and
 - » Professional support services for the industrial activities listed above.
- **Privileges granted to investors through Free Zones:**
 - » All capital invested, as well as interest and income generated, are exempt from taxes and fees throughout the lifetime of the project, including construction and start-up phases;
 - » Wages of foreign workers are exempt from taxes and allow the transfer of their income outside Iraq, and Iraqi workers benefit from having 50% of their wages exempt from income tax;
 - » Imported and exported goods and raw materials are exempt from all taxes and fees, except those exported to the interior of the country;

⁵⁸ See *id.* at art. 17/Fourth.

⁵⁹ See *The Free Zones Law No. 3 of 1998, art. 1 (Iraq)*. For further information, see *Republic of Iraq, Ministry of Fin., A completed project to attract the investments*, available at <http://freezones.mof.gov.iq/fil/dalelen.pdf>

- » Foreign currency may be transferred inside or outside or dealt within the Free Zone and will not be subject to any restrictions; and
- » Investors are granted a temporary customs privilege for entry of their vehicles according to the needs of the project.

4. OTHER RELEVANT IRAQI LAWS ON TAXES AND DUTIES

Income Tax Law No. 113 of 1982 (the main source of tax law in Iraq) and Customs Law No. 32 of 1984 require investors exempt from paying income tax under Investment Law No. 13 to nonetheless submit the required financial disclosures to the GCT. Customs Tariff Law No. 22 of 2010 regulates the percentage of customs fees on imported goods according to the rates set forth in the tariff tables of customs duties and the agricultural calendar based on the Harmonized System Coding. Customs Tariff Law No. 22 dissolved the 5% “Iraq Reconstruction Levy” on August 1, 2015.⁶⁰

H. LEGISLATIVE PROVISIONS RELATED TO POWER SECTOR

1. EXCLUSIVE JURISDICTION

Under Investment Regulation No. 2 for 2009, NIC has exclusive jurisdiction to grant an Investment License to federal strategic projects, which includes electric power projects with production capacity greater than 30 MW.⁶¹ If it is less than 30 MW, the PIC is the governing authority that may grant the license.

2. CURRENT LEGAL REFORMS

As of 2016, there were two relevant laws that have been drafted and are under consideration: the draft MoE Law and the draft Electricity Regulation Law.⁶²

a. Draft MoE Law

The draft MoE Law aims to restructure the MoE. The draft outlines new key roles for the MoE. According to the draft, the MoE’s 27 directorates are to be restructured, corporatized, and eventually privatized. The draft also authorizes the creation of an independent regulatory entity to oversee the sector, ensuring competitive, effective, and transparent electricity market. It is a major concession that the government has finally accepted a role for the private sector in the economic reform of the energy sector, as an essential step toward tackling the sector’s problems. Further, the draft legislation would mandate the government to proceed with liberalization of the power sector, limiting the MoE’s role to regulatory and licensing policies, while expanding the role of the private sector, defining consumer rights and obligations, and encouraging investment.

⁶⁰ See Republic of Iraq, MoF, Public Commission of Customs, Iraqi Tariff Table According to the Harmonized System, available at <http://www.iraq-businessnews.com/wp-content/uploads/2011/02/Iraqi-DRAFT-Tariff-Schedule.pdf?d9c344>. For further information, see *Legal Guide to Investment in Iraq*, supra note 14, at 42-45.

⁶¹ Regulation No. 2 of 2009, art. 2/Second/h (Iraq).

⁶² See *Iraq Energy Outlook*, supra note 11. Still, the bill has yet to be adopted, partly due to disagreements between various parliamentary blocs on privatization and the role of the central government in protecting national assets, and partly due to fears that reform of the electricity sector might become another divisive political issue. See Luay Al-Khatteeb & Harry Istepanian, *Turn a Light On: Electricity Sector Reform in Iraq*, Brookings Inst. (Mar. 2015), available at <https://www.brookings.edu/wp-content/uploads/2016/06/Alkhatteeb-Istepanian-English-PDF.pdf>; and Luay Al-Khatteeb & Harry Istepanian, *Iraq’s Draft Electricity Law: What’s Right, What’s Wrong?*, Brookings Inst. (Apr. 15, 2014), <https://www.brookings.edu/research/iraqs-draft-electricity-law-whats-right-whats-wrong/>.

b. Draft Electricity Regulation Law

The draft Electricity Regulation Law establishes a regulatory office for the electricity sector, with responsibility for monitoring the sector, licensing participants, enforcing technical codes, and resolving disputes and consumer complaints.⁶³

I. ENFORCEMENT OF INVESTOR AND LENDER RIGHTS

If there is a conflict between a provision of Investment Law No. 13 of 2006 and a provision of another Iraqi Law that pertains to investment, then the National Investment Law governs. Investors and related parties are to follow the procedures set forth in the National Investment Law for dispute settlement and investor violations pertaining to projects covered by the National Investment Law and related Iraqi laws.⁶⁴

1. DISPUTE RESOLUTION IN GENERAL

Dispute resolution is governed by the Civil Procedure and Actions Law No. 83 of 1969. The law governing arbitration can be found in Articles 251-276 of the Civil Procedure Law. It is permissible to agree on resolving certain disputes through arbitration, with key aspects of this particular mechanism listed below:⁶⁵

a. Arbitration Requirements

The arbitration agreements must be in writing, and arbitration procedures, location and prevailing law should be outlined and agreed upon. The dispute may not be heard by the court if it was subject to an arbitration agreement between the parties, provided the party wishing to rely on the clause makes an objection.⁶⁶ The arbitrator's acceptance to his appointment shall be in writing.⁶⁷ After accepting his appointment, the arbitrator may not quit without an acceptable excuse and may not be discharged except by the parties' agreement.⁶⁸ If resorting to the arbitration option was required to be done within a certain period of time, then such option shall terminate upon the expiry of such a period, unless the litigants agree to extend the same.⁶⁹ However, if the arbitrators failed to resolve the dispute within the agreed-upon period or the one stipulated under Iraqi Law or if they were unable to submit their report due to a force majeure, then each litigant may invoke the competent court to apply for an extension or request the court to adjudicate the dispute or appoint an alternative/another arbitrator for that purpose, as the case may be.⁷⁰ Unless the parties agree otherwise, a tribunal must comply with the procedures set out in the Civil Actions Law.⁷¹ A tribunal must give reasons for its award.⁷²

⁶³ See *Iraq Energy Outlook*, *supra* note 11.

⁶⁴ See Investment Law No. 13 of 2006, art. 34 (Iraq).

⁶⁵ See Civil Procedure and Actions Law No. 83 of 1969, art. 252-76 (Iraq).

⁶⁶ *Id.* at art. 253.

⁶⁷ *Id.* at art. 259.

⁶⁸ *Id.* at art. 260.

⁶⁹ *Id.* at art. 262.

⁷⁰ Civil Procedure and Actions Law No. 83 of 1969, art. 263 (Iraq).

⁷¹ *Id.* at art. 265.

⁷² *Id.* at art. 270.

b. Enforcing an Award in Iraq

A domestic Iraqi award cannot be enforced unless the supervising court approves it.⁷³ The court may decide to annul it on certain grounds.⁷⁴ It is noteworthy that Iraq is one of the few countries that is not a signatory to the New York Convention. Thus, enforcing an award outside Iraq depends on whether the country where enforcement is sought has a treaty with Iraq on judicial matters.

2. INTERNATIONAL CENTER FOR SETTLEMENT OF INVESTMENT DISPUTES (ICSID)

The ICSID Convention established ICSID, an international institution that provides facilities for the resolution and arbitration of investment disputes. ICSID offers services for the resolution of international disputes, primarily between investors and States, but also in the context of State-to-State disputes. In addition, it offers fact-finding proceedings to examine and report on facts before a dispute arises.

On November 17, 2015, Iraq signed the ICSID Convention and became a signatory State. The ICSID Convention entered into force in Iraq on December 17, 2015. This provides investors with a globally recognized dispute forum to seek recourse.

3. DISPUTE RESOLUTION FOR INVESTORS

a. Governing Law

Investors and related parties who are subject to provisions of Investment Law No. 13 shall resolve disputes under Iraqi law unless otherwise agreed.⁷⁵ It is worth noting that Iraq has explicitly endorsed the use of arbitration by investors.⁷⁶

b. Dispute Process

The following relevant provisions are of note:

- Any dispute that arises from a work contract shall be subject to the provisions of the Iraqi law and the jurisdiction of Iraqi courts. Any non-Iraqi worker may be exempted if the contract stipulated otherwise;⁷⁷
- If a dispute arises between the investment project partners resulting in a stoppage to the project for a period that exceeds three months, a warning shall be sent to the investor to settle the dispute within 30 days of the date of the warning. If three months elapse without settlement of the dispute, the dilatory investor may be liable for a penalty fine that is commensurate with the length of delay, provided that it does not exceed 10% of the project capital;⁷⁸
- The party in breach of its obligation shall be excluded after the period stipulated by law, which is 30 days, and shall be replaced by the partner not in breach or an approved replacement. This must be undertaken without

⁷³ *Id.* at art. 272.

⁷⁴ *Id.* at art. 273.

⁷⁵ Investment Law No. 13 of 2006, art. 27 (Iraq).

⁷⁶ *Id.*

⁷⁷ *Id.* at art. 27/First.

⁷⁸ *Id.* at art. 27/Second/A.

prejudicing the relevant Commission's right to revoke the investment license after the expiration of the 30-day period;⁷⁹

- If an investment project stops because of a dispute between the investor and third parties, and after taking into account a 30-day period in Article 27/Second/A, the Commission shall take legal action to liquidate the project and notify the project owner. Subsequently the liquidation proceeds shall be deposited in a bank after paying the dues of the State or any other dues;⁸⁰ and
- Disputes arising between the Commission or any other governmental entity and a party subject to the Investment Law but where the matter is not related to one of the provisions of the Investment Law, shall be subject to Iraqi law and courts on civil matters.⁸¹

4. INVESTOR VIOLATIONS

Article 28 of Investment Law No. 13 of 2006 outlines the recourse for the relevant Commission to take against an investor who has breached an agreement, as follows:

- If the investor violates any of the provisions of the Investment Law, the Commission shall have the right to warn the investor to resolve the violation within a specific period decided by the license issuing committee;⁸²
- If the investor does not resolve the violation within the specified period, a final warning shall be sent to the investor allotting 30 days to cure the violation from the date of warning. If the period of the final warning expires, a penalty shall be imposed that is proportional to the disparity in time, provided that the accumulated amount shall not exceed 10% of the cost of the project;⁸³
- In the case that the investor fails to provide a response within the aforementioned period, the license-issuing commission retains the right to revoke the investor's license starting from the date of the violation, while third parties retain the right to claim compensation from the investor for the damage caused to them as a result of the violation, without prejudice to any other penalties;⁸⁴ and
- Upon repeating the violation, the Commission shall have the right to revoke the investor's license it issued and order stoppage of work on the project and deny the investor the granted exemptions and privileges from the date of the violation. The Commission may allow others to demand compensation for the damage caused by this violation, without breaching any punishments or other compensations stipulated in applicable laws.⁸⁵

⁷⁹ *Id.* at art. 27/Second/B.

⁸⁰ Investment Law No. 13 of 2006, art. 27/Third (Iraq).

⁸¹ *Id.* at art. 27/Fifth.

⁸² *Id.* at art. 28/First/A.

⁸³ *Id.* at art. 28/First/B.

⁸⁴ *Id.* at art. 28/Second.

⁸⁵ *Id.* at art. 28.

J. DOING BUSINESS IN IRAQ

Iraq's Investment Law No. 13 of 2006, as amended, enables domestic and foreign eligible investors with investment license grants to enjoy the abovementioned benefits and guarantees. Domestic and foreign companies must be registered with the Ministry of Trade's Companies Registration Department to do business in Iraq.

1. INVESTMENT APPLICATION REQUIREMENTS

Article 19/Second of Investment Law No. 13 of 2006 states that the applications for investment license applications submitted by investors must include (i) the completed license application form available on the NIC website; (ii) the project financing plan accompanied by the financing party guarantee from an accredited financial institution; (iii) the list of projects carried out by the investor or its partners in or outside Iraq and the parties supporting them in its execution; (iv) details of the investment project, including an economic and technical feasibility study; and (v) the timetable for project completion.⁸⁶

2. SERVICES PROVIDED TO OBTAIN AN INVESTMENT LICENSE

The One Stop Shop department of the NIC or the relevant PIC assists potential investors obtain investment licenses. This assistance includes (i) coordinating with the offices of relevant ministries and authorities to create a list of investment opportunities for strategic projects; (ii) providing investors with market research and details about the economic climate; (iii) directing investors to authorities specialized in economic and technical feasibility studies; (iv) facilitating the required business visa application process; (v) providing information needed by investors regarding Iraqi cities and human and natural resources of the regions; and (vi) assisting with obtaining approval of sector-specific entities.

3. GRANTING AN INVESTMENT LICENSE

After the NIC or the relevant PIC receives a complete application for an investment license, the relevant entity (i) studies the application of the investor, (ii) studies the economic feasibility statement, (iii) clarifies the legal issues, (iv) obtains the approval of the relevant authorities for the investment project, and (v) assists the investor in obtaining land allocated for the establishment of the project.

Following the steps listed above, the NIC must either contact the relevant sector authorities and land owning authorities or reply to the investor within 45 days.⁸⁷ Within 15 days of notification, the relevant sector authorities and land owning authorities must study the project's economic and technical feasibility and issue a statement of an opinion on the establishment of the investment project (approve, deny, or request amendment).⁸⁸

⁸⁶ See Investment Law No. 13 of 2006, art. 19 (Iraq).

⁸⁷ *Id.* at art. 20/First, Second.

⁸⁸ *Id.* at art. 2.

In the event of a dispute between the NIC and other relevant entities involved in the license granting process (other than PICs), the dispute shall be brought before the Prime Minister for settlement.⁸⁹

4. LEGAL REGISTRATION AND ESTABLISHMENT OF COMPANIES

Under Company Law No. 21 of 1997, a foreign or domestic person or entity has the right to acquire membership in a company.⁹⁰ The investors must first determine what category the company in question belongs to.⁹¹

a. Establishing the Company

Under Article 13 of Company Law No. 21 of 1997, the founders of the company shall prepare a contract that shall contain the following information:

- The company's name and form;
- The company's head office, which must be in Iraq;
- Deposit of appropriate capital for the company, in IQD, at an authorized Iraqi bank and notification to the Companies Registrar of the same;
- The purpose of establishing the company and its nature;
- The capital divided in quotas and shares;
- The method of distributing profits and losses; and
- The address of the company's commercial activity in Iraq, including any branches and other types of foreign company entities in Iraq.

The application for establishment shall be submitted to the registrar with the company's contract and a statement from the bank that the capital required has been deposited.

b. Registering with the MoE

Any company that wishes to register with the MoE and provide additional information about the company to the MoE can obtain and complete an informational form from the MoE and email the form in Word to the Department of Investments and Contracts within the MoE.⁹²

c. Investor Obligations

There are certain investor obligations in terms of project implementation and commercial operation after the investment license is granted, which can be broken down into (i) notification and reporting requirements, (ii) employment and labor requirements, and (iii) environmental, safety and public order requirements.

5. NOTIFICATION AND REPORTING REQUIREMENTS

After an investment license has been granted and an investment project has commenced, the investor must meet certain obligations to keep the NIC, the PICs, and other relevant agencies informed of the status of the investment project, in addition

⁸⁹ *Id.* at art. 20/Third.

⁹⁰ Company Law No. 21 of 1997, ch. 1, sec. 3, art. 12 (Iraq).

⁹¹ *Id.* at ch. 2, sec. 1, art. 13.

⁹² For registration information, see Ministry of Electricity, Republic of Iraq, <http://www.moelc.gov.iq/index.php?name=Pages&op=page&pid=210>.

to honoring the commitments made when applying for a license. Under Article 14 of Investment Law No. 13 of 2006, the investor shall (i) notify the NIC, the Region or Governorate Commission in writing immediately following the installation and equipping of fixed assets for the purposes of the project and the date of the beginning of commercial activity;⁹³ (ii) keep proper records audited by a certified accountant in Iraq, in accordance with Iraqi law;⁹⁴ (iii) provide a technical and economic feasibility study for the project and any information, data, or documents required by the Commission or other competent authorities regarding the budget of the project and progress made;⁹⁵ (iv) keep records of the project's duty-free imported materials and specify the depreciation periods of these materials;⁹⁶ (v) protect the safety of the environment and adhere to the valid quality control systems in Iraq and international regulations accredited in this field;⁹⁷ (vi) commit to the correspondence of the work progress schedule by the investor with reality provided that that the time difference shall not exceed six months, and the NIC shall have the right to withdraw the license and shall set forth punitive conditions if the six-month period is exceeded;⁹⁸ (vii) adhere to the provisions stipulated in the Commercial Bookkeeping Regulation No. 2 of 1985 required for income tax;⁹⁹ and (viii) determine the depreciation of materials imported for the project in accordance with the Depreciation Regulation No. 9 of 1994, which includes using the historical value of fixed assets as a base for calculating depreciation.¹⁰⁰

6. EMPLOYMENT AND LABOR REQUIREMENTS

Employment and labor requirements derive generally from two sources: Investment Law No. 13 of 2006 and the Ministry of Labor Worker's Retirement (WR) and Social Pension Organization (SPO).

- Under Article 14/Sixth of Investment Law No. 13 of 2006, investors must adhere to Iraqi and international legal standards for labor regarding salaries, vacations, and work hours and conditions, in addition to the following requirements:
 - » Employment priority must be given to Iraqi workers, if possible;
 - » Iraqi nationals must make up at least 50% of the workforce in the project;¹⁰¹
 - » Investors have the right to employ non-Iraqi workers only where Iraqis with the requisite skills and qualifications are not available;¹⁰² and
 - » A foreign investor's company must train and rehabilitate its Iraqi employees and raise their efficiency, skill, and capabilities. Priority in employment shall be given to Iraqis.¹⁰³

⁹³ Investment Law No. 13 of 2006, art. 14/First (Iraq).

⁹⁴ *Id.* at art. 14/Second.

⁹⁵ *Id.* at art. 14/Third.

⁹⁶ *Id.* at art. 14/Fourth.

⁹⁷ *Id.* at art. 14/Fifth.

⁹⁸ Investment Law No. 13 of 2006, art. 14/Seventh (Iraq).

⁹⁹ *Id.* at art. 17.

¹⁰⁰ *Id.* at art. 18.

¹⁰¹ Investment Regulation No. 2 of 2009, art. 30/First (Iraq).

¹⁰² Investment Law No. 13 of 2006, art. 12/First (Iraq).

¹⁰³ *Id.* at art. 14/Eighth.

- All companies must register with the Ministry of Labor Worker's Retirement (WR) and Social Pension organization (SPO) before beginning any activities.¹⁰⁴
 - » Social Security deductions equal to 17% of an employee's wages shall be paid quarterly. Employers are responsible for 12%, with the remaining 5% paid by employees;¹⁰⁵ and
 - » Payments should be made by employers to the WR and SPO by certified check.
- Iraqi Labor Law requires that the investor maintain required work conditions and hours and train Iraqi employees based on requirements under the Ministry of Labor and Social Affairs. The Iraqi Labor Law of 2015 governs workplace safety matters. Employers are required to ensure healthy conditions at the workplace and take sufficient safety measures to protect workers. The safety measures include: (i) providing a safe and secure workplace environment; (ii) providing workers with training to avoid occupational hazards; (iii) educating workers on occupational health and safety and clearly displaying applicable rules related to occupational risks; (iv) providing first aid equipment; (v) providing safety instructions whenever necessary; (vi) protecting workers from any immediate danger (such as explosions); (vii) providing workers with appropriate safety devices and clothing for protection against any hazards; (viii) clearly indicating potentially hazardous locations; (ix) providing emergency rescue and first aid tools; and (x) implementing periodic workplace inspections.

The National Center for Occupational Health and Safety (NCOHS) oversees the implementation of safety requirements in the Labor Law. The NCOHS decides on a case-by-case basis whether certain types of work warrant special requirements (such as reduced hours).¹⁰⁶

7. ENVIRONMENTAL REQUIREMENTS

To operate in Iraq, a project must comply with certain Iraqi Environmental and Antiquities and Heritage Laws.

a. *Environmental Impact Assessment*

According to Ministry of Environment Law No. 37 of 2008, all investors must study the environmental impact of the project and the degree to which it conforms to the environmental conditions required. Project companies may not begin work on a project until the Ministry of the Environment issues an approval. Project companies must produce an environmental impact assessment that includes the following:

- Calculation of both negative and positive environmental impacts on the surrounding environment (in relation to the perceived production benefits),
- Proposed method of avoiding pollution,
- Proposed method of treating pollution,

¹⁰⁴ See National Investment Commission, *Investor Guide to Iraq 2015* 34 (2015), available at http://www.iraq-jccme.jp/pdf/arc/investors_guide_2015.pdf.

¹⁰⁵ Pension and Social Security Law No. 39 of 1971 (Iraq).

¹⁰⁶ Investment Law No. 13 of 2006, art. 15/Fifth (Iraq). See also Commercial Law Dev. Program, *Legal Guide to Investment in Iraq*, *supra* note 14, at 49-50.

- Calculation of the probability of a pollution-related emergency and necessary preventative precautions,
- List of alternatives technology that can be used to minimize environmental harm less harmful for the environment and rationalizing the resources usage,
- Plan to reduce waste, and
- Evaluation of the project's environmental feasibility

For more information on obligations relating to environmental protection, please consult Law 27 of 2009 relating to the Improvement and Protection of the Environment.

b. Antiquities and Heritage Law

Investors must also comply with the Antiquities and Heritage Law No. 55 of 2002, which requires investigating and digging for antiquities on the land designated for the investment project.

c. Absence of Oil Pipeline Restrictions

The approval of the MoO required for the issuance of an Investment License will only be granted after verification that there are no oil pipeline restrictions within the land area of the project (Ministry of Oil Law No. 101 of 1976). The Ministry of Industry and Minerals Law No. 38 of 2011, which emphasizes the implementation of scientific methods and quality control, seeks to ensure optimum mineral investment through effective exploitation while preserving natural resources and protecting the environment and improving quality.

K. IRAQ POWER GENERATION SUCCESS STORIES

Over the course of the past decade, many notable foreign investment projects have taken place in Iraq, including some in the power sector. Billions of dollars were invested from foreign private investors who have succeeded in completing projects and have begun operations.

1. AL-KHAIRAT POWER PLANT: “BEST GLOBAL PROJECT”

Çalık Enerji, is a leading energy company headquartered in Turkey. The existing markets of Çalık Enerji are Turkey, Turkmenistan, Uzbekistan, Iraq, Georgia, Libya, and Kosovo.¹⁰⁷

In 2014, Çalık Enerji completed a power plan with 1,250-MW capacity in Al-Khairat Region, Karbala.¹⁰⁸ As part of the agreement made in 2011, the power plant was built with 10 gas turbines purchased by the GoI from General Electric (GE).¹⁰⁹ The power plant is not an IPP as it is operated by the MoE. The Al-Khairat Natural Gas Cycle Power Plant was completed in two years and selected as the “Best

¹⁰⁷ Çalık Enerji, <http://eng.calikenerji.com/Pages/Çalık%20Enerji.aspx>.

¹⁰⁸ Çalık Holding, *Annual Report 2014*, available at http://i.tmgrup.com.tr/calik/2015/12/03/clk_frae_2014-1449134840893.pdf.

¹⁰⁹ Çalık Enerji, Çalık Enerji Invests 445.5 Million Dollar in Iraq for a Power Plant, <http://eng.calikenerji.com/Pages/NewsDetail.aspx?ID=27>.

Global Project” in 2013.¹¹⁰ The plant, constructed for an estimated US\$445.5 million, will supply electricity to millions of citizens. The cost is to be repaid based on a deferred payment system as agreed with the Turkish government.¹¹¹

2. ZAKHO PROJECT

The Zakho Project, which commenced in 2014, entails the development, design financing, construction, testing, commissioning, ownership, and operation of a 1,260 MW greenfield natural gas-fired gas turbine combined cycle power plant, executed on a BOO basis. The power plant and its substation will be located in Zakho City in the Kurdistan Region once complete.¹¹² Kurdistan Regional Government (KRG) will construct a short gas pipeline to supply natural gas to the power plant.

The financing of the project is sourced by IFC. Financing is taking place in two phases in conjunction with the two phases of the power plant’s development. Phase 1A will consist of a 560 MW open-cycle phase gas-fired gas turbine including the associated 400/132/11 kV Dohuk substation and a 40km 400kV overhead transmission line. Phase 1B will consist of 280MW open-cycle gas-fired gas turbine. Phase 2 will consist of conversion of the open-cycle gas turbines to CCGT with three heat recovery steam generators. IFC is investing a total of US\$578 million, which will cover the cost of phase 1A. The proposed IFC investment is (i) up to US\$100 million of A Loans for IFC’s own account, (ii) up to US\$65 million of IFC’s Managed Co-Lending Portfolio Program Loan, and (iii) up to US\$240 million of B / Parallel Loans. However, subject to final lender appetite, the financing package may be increased by an additional US\$140 million pro rata to accommodate Phase 1B, which has a cost of US\$204 million.¹¹³ Lastly, the project is sponsored by UNIT Investment N.V., Polteks Insaat A.S. and will be developed by UNIT and Polteks. The project has been awarded a 15-year PPA by the MoE to design, construct, and operate the Project.¹¹⁴

3. GE MEGA DEAL

In January 2016, GE signed an agreement with the MoE to provide equipment and maintenance for 10 power plants across Iraq, which will boost electricity production by 1,000 MW. GE has begun shipping parts and commenced the projects at the MoE plants in Iraq. The technology upgrades include heavy fuel oil (HFO) conversions that will help scale up productivity in addition to installing advanced hot gas path components at the various gas turbines.¹¹⁵ The GoI will pay GE in deferred payments over three years, and the MoE’s commitment is backed by a sovereign guarantee.¹¹⁶

¹¹⁰ Debra K. Rubin, *Global Best Industrial Project: Al Khairat Gas Turbine Power Plant, Iraq*, Engineering News-Record (May 7, 2014), <http://www.enr.com/articles/7397-global-best-industrial-project-al-khairat-gas-turbine-power-plant-iraq?v=preview>.

¹¹¹ *Work Starts at \$450m Karbala Power Station*, Iraq-Business News, <http://www.iraq-businessnews.com/2011/05/09/work-starts-at-450m-karbala-power-station/>.

¹¹² Int’l Fin. Corp., *Unit Zakho: Environmental & Social Review Summary*, <http://ifcext.ifc.org/IFCExt/spiwebsite1.nsf/78e3b305216fcd8a85257a8b0075079d/98b86f657de6179a85257ca50076be83?opendocument>.

¹¹³ *Id.*

¹¹⁴ *Unit & Polteks Ltd., Zakho Natural Gas-Fired Power Plant, Duhok Substation and Overhead Transmission Line Project: Environmental and Social Impact Assessment (ESIA) Report Non-Technical Summary*, available at [http://ifcext.ifc.org/IFCExt/spiwebsite1.nsf/0/98B86F657DE6179A85257CA50076BE83/\\$File/UNIT%20Zakho%20NTS%20Mar%202014.pdf](http://ifcext.ifc.org/IFCExt/spiwebsite1.nsf/0/98B86F657DE6179A85257CA50076BE83/$File/UNIT%20Zakho%20NTS%20Mar%202014.pdf).

¹¹⁵ General Electric, *GE Signs Agreement with Iraqi Ministry of Electricity; GE Power Up Plan to Sustain and Increase Iraq’s Power Generation for the Peak Summer Period*, GE Newsroom (Jan. 28, 2016), <http://www.genewsroom.com/press-releases/ge-signs-agreement-iraqi-ministry-electricity-ge-power-plan-sustain-and-increase-iraq>.

¹¹⁶ See Rasheed, *supra* note 9.

L. CHALLENGES/RISKS

Although Iraq is attractive to domestic and foreign investors from a legal perspective, understanding the risks and challenges that investors face will allow better business decisions to be made in regards to how investments operate. Iraq has made limited progress enacting certain key laws and many investors face concerns about security, corruption, infrastructure, and societal stability.¹¹⁷

1. SECURITY

An obstacle foreign investors face when entering the Iraqi market is the uncertainty faced due to the Islamic State (IS). In June 2014, IS took control of Mosul and Iraq's economic development has suffered as a result. Namely, Iraq's power sector has become fragile and the MoE announced grid losses of more than 8,000 MW.¹¹⁸ IS relies on funding from various sources, including the appropriation of cash held at state-owned banks, exploitation of oil fields and the extortion of a portion of salary payments of Iraqi government employees. Iraq has made a commitment to work with the inter-governmental Financial Action Task Force (FATF) and MENA-FATF to address the issue of terrorism, but the security issues still prevail due to the insufficient progress of this program.¹¹⁹ To address this challenge, the Iraqi Security Forces and the international Coalition to Counter ISIL, led by the United States, have partnered to combat IS. A proposed stabilization and rebuilding process will follow military operations to eradicate IS and reintegrate large parts of the country.

2. TARIFF STRUCTURE AND PAYMENT RECOVERY

The tariff structure in Iraq suffers from an unduly low cost to end-users and revenue collection is estimated at one-third of what actually enters the distribution network.

Electricity from the grid is heavily subsidized by the government, leading to minimal incentive to the consumer to use electricity efficiently. Iraq's tariff structure charges US\$.01 per kilowatt-hour consumed, with higher prices being charged when more than 20,000 kilowatt-hours are consumed.¹²⁰ Iraq's tariff rates are about one-tenth of the rates in other MENA countries. Further, the tariffs only cover about 10% of the cost to the MoE.¹²¹ The low rates encourage consumers to focus their usage on grid-based electricity rather than on private generators, which further hamper the grid. Until the quality and duration of electricity enhances in Iraq, it will be difficult for the MoE to increase tariff rates because such a decision will be greatly opposed by the public.

The lack of metering and payment collection for electricity usage is another challenge that must be taken into consideration. It is estimated that tariff revenue is

¹¹⁷ Cent. Intelligence Agency, *Middle East: Iraq*, The World Factbook, <https://www.cia.gov/library/publications/the-world-factbook/geos/iz.html> (last updated Aug. 15, 2016).

¹¹⁸ See Al-Khatteeb & Istepanian, *Turn a Light On*, *supra* note 69.

¹¹⁹ Int'l Monetary Fund, *2015 Article IV Consultation and Request for Purchase under the Rapid Financing Instrument – Press Release; Staff Report; and Statement by the Executive Director for Iraq*, IMP Country Report No. 15/235 (Aug. 2015), available at <http://www.imf.org/external/pubs/ft/scr/2015/cr15235.pdf>.

¹²⁰ See World Bank Group, *Iraq Public Expenditure Review*, *supra* note 3.

¹²¹ See Al-Khatteeb & Istepanian, *Turn a Light On*, *supra* note 69.

collected for only one-third of the electricity that enters the distribution network.¹²² In addition to the lack of payment collection, it is difficult for investors to properly cover their operating expenses and recover their cost of capital due to the illegal networks provided by the private generators.

3. OSCILLATING OIL PRICES

Excessive dependence on oil as a form of revenue makes Iraq highly vulnerable to changes in international oil prices. The recent fall of oil prices drastically reduced Iraq's revenue from oil exports, which accounts for more than 90% of Iraq's budget. Although Iraq has the fifth largest proven oil reserves in the world, the GoI has publicly stated its commitment to attract foreign investment and is committed to diversifying Iraq's economy to be less reliant on oil exports.¹²³ A major challenge that has evolved from the fall in oil prices is the limitation placed on the financing of government contracts and tenders, which is the source of many commercial opportunities in Iraq. The reason these contracts and tenders have been limited is because they are widely financed by oil revenues. The Iraqi government is interested in attracting assistance and loans from foreign financial institutions in order to address this concern. For further information, see the *2015 Investment Climate Statement*.

¹²² See Iraq Energy Outlook, *supra* note 11 and The World Bank, Republic of Iraq Public Expenditure Review: Toward More Efficient Spending For Better Service Delivery (2014).

¹²³ See U.S. Dep't of State, *Iraq: Investment Climate Statement 2015* (Jun. 2015), available at <http://www.state.gov/documents/organization/241811.pdf>.

CHAPTER III. FINANCING OF POWER PROJECTS

A. INTRODUCTION

This chapter addresses project finance in general, including an overview of project partnerships, public and private financial institutions, credit enhancements, and secured transactions. In addition to this broad survey, this chapter also addresses the current condition of Iraq's power project environment, specifically in regards to administrative procedures and sources of funding.

B. OVERVIEW OF PROJECT FINANCE

Project finance is the financing of large infrastructure or commercial projects, such as power plants, transmission networks, other energy projects, roads, waterways, and more. Project finance is usually done on a long-term basis and based on the project's projected cash flows rather than on the balance sheet of the borrower or its sponsor. Project finance is a means of financing a company created for the specific purpose of owning, constructing, and operating a project, with limited or no recourse to the company's shareholders. This means that the shareholders of the project company will have limited or no liability for the debts and obligations of the project company. Project finance is especially suitable for long-lived, large-scale, capital-intensive investments.

Project finance transactions have more complexity than balance sheet financing. There are large up-front costs that are incurred due to the multiple parties, financing and legal documents, and technical studies along with extensive due diligence required. Often times, the sovereign (or government offtaker) grants certain concession rights related to the building, ownership, and operation of a project to a special purpose company whose sole business is the building, ownership, and operation of the project. The project company typically contracts third parties to perform certain of those obligations (such as construction and operation). The principal financing documents can include a common terms agreement, loan facility agreements, security documents, an accounts agreement, an Intercreditor agreement, hedging documents, direct agreements with the counterparties to the key project documents, and shareholder agreements and/or equity subscription agreements.¹²⁴

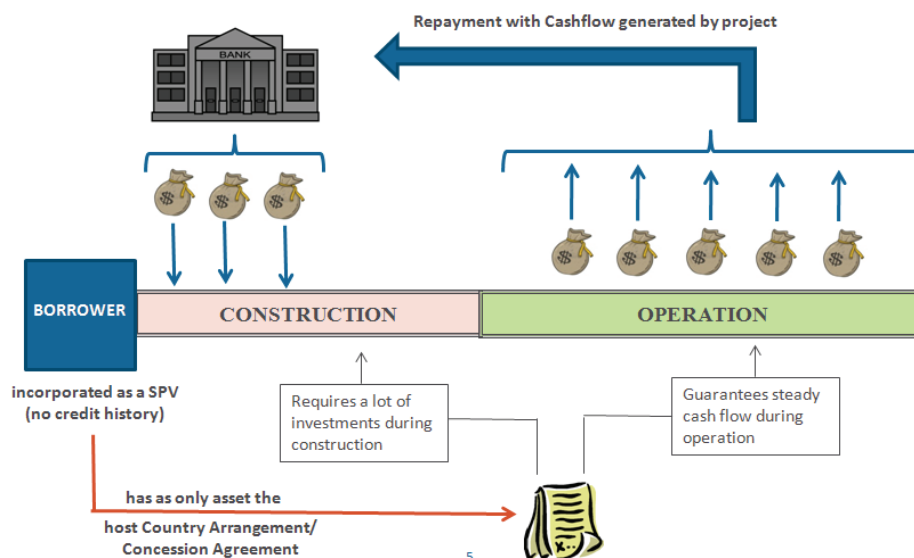
Public-private partnership (PPP) projects can generally be classified into entirely privately financed long-term structures, such as Build-own-operate-transfer (BOOT) and Build-own-operate (BOO), and short-term IPP structures such as Design, build, finance, and operate (DBFO) and Build-operate-transfer (BOT), which employ more public finance. A comprehensive list of structures is attached to the end of this chapter.¹²⁵

¹²⁴ For more information on the basics of project finance, please see *Understanding Power Project Financing*, 2 Power Africa Understanding Series ch. 3, available at <http://cldp.doc.gov/sites/default/files/UnderstandingPowerProjectFinancing.pdf>.

¹²⁵ *Id.*

C. REFINANCING THE PROJECT THROUGH A SPECIAL PURPOSE VEHICLE

The borrower, with generally limited recourse to sponsors, typically uses a special purpose vehicle (SPV), a separately incorporated legal entity with limited liability for the project. The use of an SPV isolates the liability of the project in a separate entity and provides assurance that the project company will not have prior liabilities.¹²⁶ In addition, SPVs shield the assets of the sponsors of the project. Unlike a corporate loan, financing with the use of an SPV does not depend primarily on the borrower's creditworthiness, but rather on the strength of the project, measured in terms of its structuring and its finances. Loans are typically secured by the assets of the project, including contractual rights, and a suitable sovereign guarantee. Note, SPVs in Iraq are not typically used, but they can be done. It is therefore prudent for the investor to seek local Iraqi counsel in creating SPVs using Iraqi law and procedures.



D. FINANCIAL INSTITUTIONS

Financial institutions play a key role in project finance transactions. There are a broad range of institutions involved and some of the most influential are the Development Finance Institutions (DFIs), Export Credit Agencies (ECAs), Political Risk Insurance Providers, and commercial and local banks.

1. DEVELOPMENT FINANCE INSTITUTIONS / EXPORT CREDIT AGENCIES

DFIs provide an alternative to traditional financial institutions for areas either not generally exposed to project finance or with heavily restricted markets. DFIs encompass a growing range of alternative financing institutions, but all with a

¹²⁶ See Commercial Law Dev. Program, *Legal Guide to Investment in Iraq*, supra note 11, at sec. 2.

common mandate of providing finance to promote development and poverty reduction. DFIs are often more concerned with environmental, social, and other policy guidelines. The shareholders of DFIs are typically governments, although occasionally other financial institutions or organizations do hold shares. DFIs can be broadly categorized as multilateral, bilateral, or regional.

Multilateral DFIs are established by more than one country and are subject to international law. These DFIs can be composed of several national governments as well as international or private institutions. Each multilateral DFI has its own independent legal and operational status although they often have similar mandates allowing them to cooperate on transactions. Due to their size, multilateral DFIs have a greater financing capacity than bilateral DFIs. Examples of multilateral DFIs include the International Finance Corporation, a branch of the World Bank (IFC), the Multilateral Investment Guarantee Agency, a member of the World Bank (MIGA), EIB, KFED, OFID, the European Commission, and the Nordic Investment Bank.

Regional development banks have a similar function to multilateral development banks or institutions, but with a regional focus. Shareholders usually consist of the regional countries, with additional major donor countries. Examples include the Caribbean Development Bank, the African Development Bank, the Inter-American Development Bank (IADB), the Asian Development Bank, Islamic Development Bank the EBRD, and the Eurasian Development Bank.

Bilateral DFIs are majority-owned by national governments and have historically served to implement government foreign development and co-operation policies in their investments in developing countries. Examples of bilateral DFIs include the CDC Group plc (UK) (CDC), Proparco (France), Norfund (Norway), Swedfund (Sweden), Netherlands Development Finance Company (Netherlands), the OPIC (United States), JBIC (Japan), and JICA (Japan).

There is a broader category of government-backed financial institutions known as ECAs, which are typically private or quasi-governmental institutions that act as an intermediary between governments and exporters to issue export financing, frequently acting as underwriters on long-term loans. ECAs provide significant funding for project finance in developing countries, which means the distinction between ECAs and DFIs can be blurred. However, ECAs have a broader mandate, namely to assist the national economy (of that ECA) by financing and insuring against loss in respect of foreign purchases of that country's goods in circumstances where commercial lenders are unable or unwilling to accept the political or commercial risks. While this chapter focuses on commercial lenders' engagement with DFIs, increasingly in emerging market deals, the involvement of an official government bank or export credit agency is becoming the norm rather than the exception. Examples of ECAs include KEXIM (Korea), K-Sure (Korea), Sinosure (China), US ExIm (United States), and the UK Export Credits Guarantee Department (United Kingdom).“Traditionally, DFIs provided relatively simple financial instruments such as grants or concessional loans (i.e., loans that are extended on terms

substantially more generous than market loans, either through low interest rates, longer grace periods, or a combination of both). However, an appetite for more sophisticated products has grown rapidly and an innovative range of financial instruments are now being issued by DFIs, including equity and quasi equity instruments, guarantees, and hedging instruments. In February 2013, IFC partnered with Standard Chartered Bank as sole arranger to launch the first RMB-denominated note. This note issuance was designed to increase IFC's opportunities to fund private sector development in emerging-market countries. Other alternative financial products, such as microfinance, social bonds or, on a smaller scale, peer-to-peer lending, are on the rise. While these alternative financial products may not present current opportunities for partnership with commercial lenders, they should be carefully watched by the commercial sector.

Together with principal financing functions, DFIs can also act as management consultants and technical advisors, equipped to provide a complete package of services and consultancy skills in developing countries. The business of development finance, however, is not designed to compete with the commercial finance sector. The EBRD, for example, states that its loans are designed to “complement” rather than “displace” private sources of finance. These loans, which are in no way subsidies, deliberately price debt at a mark-up level that reflects genuine country and project risk, including administration costs, commission fees, structuring fees, outside counsel fees, and commitment fees at market rates. Listed below are some of the several advantages of co-financing with a DFI lender, for both the beneficiary and other commercial lenders.

- **Risk Guarantees** – A DFI is mandated to facilitate investment in developing economies, which often carry a high-risk, unstable profile. Risk mitigation is one of the most significant benefits of co-financing with a DFI, usually provided in the form of a guarantee. These guarantees can range from all-risk guarantees against all defaults, regardless of the cause, to partial risk guarantees (PRGs), which cover defaults arising from specified events (e.g., sovereign non-obligation and political risks).¹²⁷ A DFI will consider the optimum level of risk by balancing the costs of managing elevated levels of risk with their liquidity requirements, institutional credit ratings, and the cost of borrowing. As a result, these guarantees encourage commercial lenders to invest in frontier markets higher risk sectors than they might otherwise.
- **Partial Risk Guarantees (PRG)** – A PRG facilitates private sector investments by covering private lenders or investors against the risk of a government or public entity failing to perform its contractual obligations in respect to a private project. PRGs ensure the payments and typically cover outstanding principal and accrued interest of the debt tranche. Eligible projects consist of BOT and PPP projects that have private participation and are dependent on certain government contractual obligations. PRGs cover a broad category of risks, including changes in the country's legal framework, nonperformance of

¹²⁷ For information on Enclave PRGs, see World Bank Group, *World Bank Guarantee Products: IBRD Enclave Partial Risk Guarantee (PRG)*, available at <http://siteresources.worldbank.org/INTGUARANTEES/Resources/IBRDEnclavePRG.pdf>.

contractual obligations, expropriation, nationalization, and foreign currency availability and convertibility, among other risks. Lastly, PRGs can cover both foreign and local currency for a broad range of commercial debt instruments.¹²⁸

- **Longer Maturity** – Significantly for beneficiaries, development finance loans are characterized with longer maturity periods than commercial loans (typically 10 to 15 years, rather than three to five years), which can be tailored to suit the individual project. Similarly, a beneficiary can benefit from longer grace periods. Often, loans will be structured in two tranches (A and B loans), where the DFI will fund a portion of the loan (with a longer tenure), and the remaining portion will be syndicated to commercial lenders. The flexibility provided by such loans allows all parties to maximize the sources of finance available and structure the finance appropriately.
- **High Level of Liquidity** – Because the majority of funds are prepaid in stock, DFIs have the opportunity to offer additional callable capital, exemptions on dividends, and corporation tax. DFIs are also able to borrow at sub-LIBOR rates due to high institutional credit ratings (usually AAA due to state guarantees and income from trading in borrowings).

The benefits from co-financing flow both ways. For the project and beneficiaries, it increases the amount of resources available for funding projects. For the DFI, it engages the international debt market in sustainable trade with developing markets. For the commercial lenders, it opens up opportunities in new economies with the protection of risk guarantees and support from the DFI.

2. POLITICAL RISK INSURANCE PROVIDERS

Domestic and foreign investors, as well as banks, face a number of risks when conducting business overseas. While some risks can be mitigated or allocated through due diligence, a number of risks are difficult to mitigate or assess and allocate effectively. Political force majeure is a risk that overseas projects may face and is difficult to assess or allocate as it is independent of the projects and not under the control of any parties to the project. Thus, political risk insurance (PRI) may be obtained to guarantee the investment and may be used as a tool to mitigate the political risk. PRIs also provide greater access to financing as there is less of a risk that unforeseen circumstances will hinder the ability of the debt to be repaid.

a. Providers¹²⁹

PRI can be provided by both public and private insurers. Private PRI providers have greater flexibility in the types of projects and breadth of coverage they can offer, but they have a lower risk tolerance than public PRI providers and typically have shorter tenors. Public providers include both ECAs and DFIs. Public providers include but are not limited to MIGA and OPIC. These providers are typically mandated to

¹²⁸ For more information on PRGs, see *World Bank Group, Partial Risk Guarantees (PRG)*, available at <http://web.worldbank.org/external/default/main?theSitePK=3985219&pagePK=64143534&contentMDK=20260268&menuPK=64143504&piPK=64143448>.

¹²⁹ See *Multilateral Inv. Guar. Agency, About Political Risk Insurance*, <https://www.miga.org/Pages/Resources/AboutPoliticalRiskInsurance.aspx>.

support the policy goals of their sponsoring government institutions, such as facilitating exports in emerging markets. Given the political clout the backers of public insurance providers have, securing at least a portion of a project's PRI cover from a public insurer with a diverse set of strong backers such as MIGA can be an effective tool in managing political risk. ECAs typically support investors and lenders of their home country investing in foreign countries.

The Berne Union is the leading global organization for the export credit and investment insurance industry. With over 80 member companies around the world, an investor may find a diverse group of providers that have different risk appetites.¹³⁰

b. Coverage

PRI policies generally insure eligible projects against losses relating to asset-backed and trade-related risks. Asset-backed risks include confiscation, expropriation, nationalization, forced abandonment, war, terrorism, civil disturbance, license/permit cancellation, and political violence. Trade-related risks include currency inconvertibility and transfer restriction, contract frustration, breach of contract, non-honoring of financial obligations, and wrongful/unjust withdrawal of a guarantee.

c. Commercial and Local Lenders

Commercial and local lenders may also provide financing to a project finance transaction in a more traditional lending form. These commercial lenders may include banks, insurance companies, credit corporations, and other lenders. Commercial lenders are more likely to be risk averse, so their financing costs may be higher than those of other financial institutions, such as DFIs and ECAs, for which providing project financing is more common and more closely aligned with their mission or mandate. Sometimes commercial lenders are strategically chosen from multiple countries, and there may also be reasons for involving local banks as commercial lenders.

E. GOVERNMENT FINANCING

Government-financed PPP significantly reduces the amount of capital investment needed from a private party, decreasing the level of risk transfer and weakening private sector incentives to create value for money. In this way, government-financed PPP makes it somewhat easier for a private party to abandon the project in the event that complications arise. Nonetheless, there are several reasons why governments may choose to provide financing for PPP projects, including (i) avoiding excessive risk premiums, (ii) mitigating government risk, and (iii) improving availability or reducing cost of finance.

Governments can contribute to the financing structure of a PPP in several ways. They can provide:

- Loans;
- Government guarantees on commercial loans; and/or
- Direct financial grants to project companies.

¹³⁰ See <http://www.berneunion.org/about-the-berne-union/berne-union-members/> for a full list of members.

Government-owned development banks and other financial institutions can also be involved, either as entities established specifically to support the PPP program or as providers of finance to PPPs as part of a broader portfolio. Governments can also retain ongoing responsibility for capital expenditures without the involvement of private sector entities.

By using private finance, governments reduce their spending obligations, enabling the redirection of public resources to other development priorities. These types of projects allow governments to (i) transfer construction and operation risks to the private sector, (ii) ensure timely completion of the construction, (iii) guarantee supply to support industrial development, (iv) share political risk with Lenders and DFI/ECAs, (v) improve accountability in the provision of infrastructure and public services, and (vi) improve reliability and availability.

F. PPP VALUE DRIVERS

PPP value drivers, which increase the value for money, include: (i) whole-of-life costing, (ii) risk transfer, (iii) upfront commitment to adequate maintenance and predictability/transparency of whole-of-life costs, (iv) focus on service delivery, (v) innovation, (vi) asset utilization, (vii) mobilization of additional funding, and (viii) accountability.¹³¹

PPPs can reduce whole-of-life costing due to full integration. When one party is responsible for each aspect of the project, it is incentivized to ensure each part is done correctly and efficiency is created. PPPs also transfer the risk of the project from the government to a private party, which may be better equipped to manage the project.

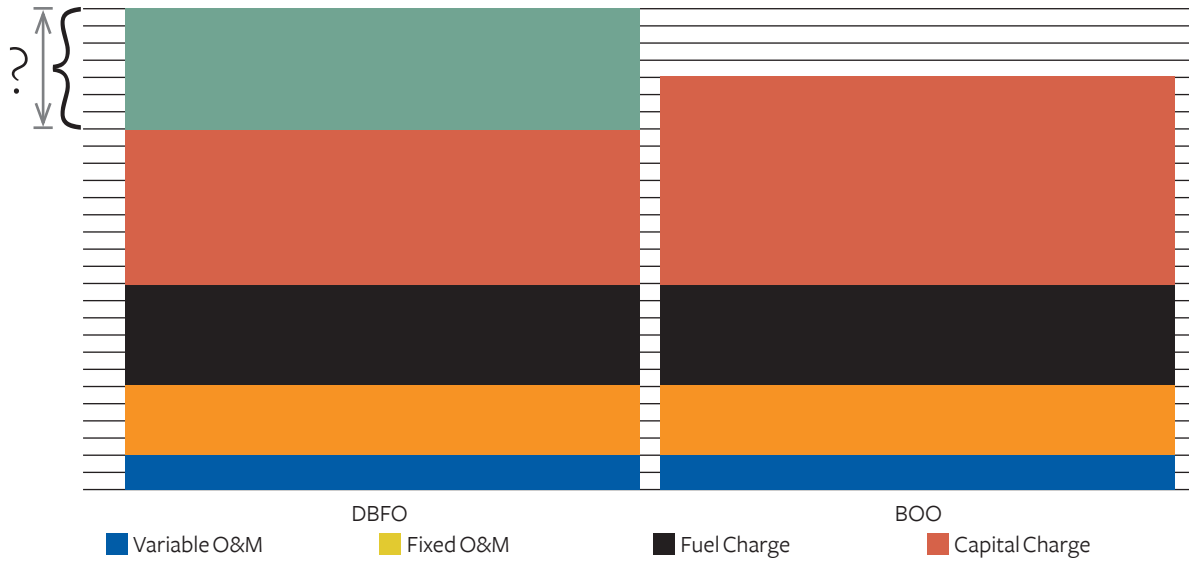
There is more opportunity for innovation as well, both through competitive procurement of contracts for PPPs, which motivates bidders to come up with creative solutions, and the creation of greater opportunities.

Private parties may also be more motivated than the government to reduce costs and improve asset utilization, as governments can be inefficient and bureaucratic in their operation and management of an asset. Similarly, the use of private parties mobilizes additional funding opportunities and can create greater accountability in the development, construction and operation of a project. Government payments to the private party may be conditioned on the private party's performance.¹³²

The below chart depicts the relative costs of DBFO projects as compared to BOO projects. While DBFO projects cost less in nominal terms, when the implied costs (i.e., inefficiencies) are factored in, the project may end up costing more to a government.

¹³¹ The World Bank, *Public-Private Partnerships Reference Guide (1st v. 2012)*, available at <http://www.ppiaf.org/sites/ppiaf.org/files/publication/Public-Private-Partnerships-Reference-Guide.pdf>.

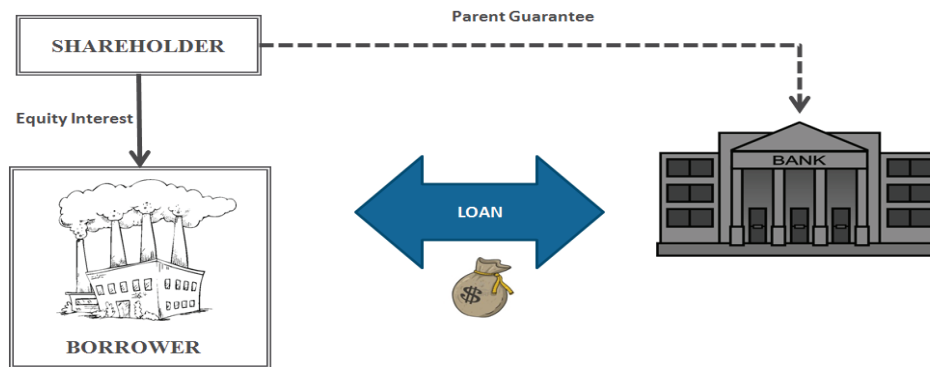
¹³² *Ibid.* See also Mustafa Alshawi, *Concept and Background to Public Private Partnership (PPP) / Private Finance Initiative (PFI): UK Experience, Iraq Inst. for Econ. Reforms (Nov. 20, 2009)*, available at <https://www.oecd.org/mena/47562550.pdf>; and Patrick Sabol and Robert Puentes, I, Brookings Inst. (Dec. 2014), available at http://www.brookings.edu/~media/research/files/reports/2014/12/17-ppp/bmpp_privatecapitalpublicgood.pdf.



G. ALTERNATIVE FUNDING SOURCES

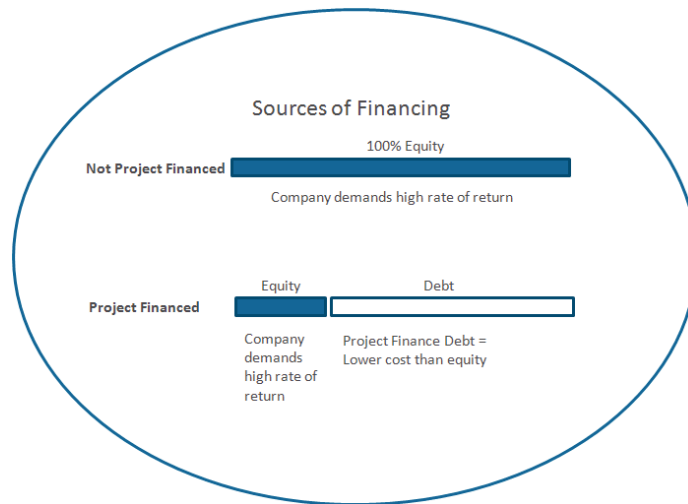
1. FINANCING A PROJECT VIA CORPORATE LOAN

Lenders of a corporate loan extend credit to the borrower based on the borrower's creditworthiness and the risk attached to the specific project. If the borrower's credit ratings or credit history is not sufficient, it is common to have a shareholder of the borrower guarantee the loan.



a. Financing a Project Using Equity

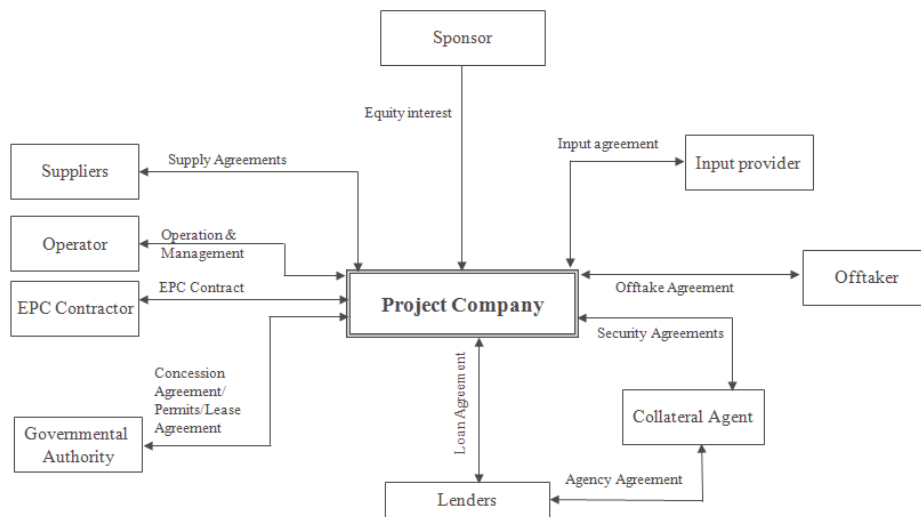
Companies can finance a project either partially or entirely through the use of equity but often financing consists of equity and debt. Equity is an expensive source of funding due to the added risk investors bear. Debt, alternatively, is a less expensive source of funding than equity because a lender has a first claim to the assets of a project in the event of default on a loan (traditionally referred to as collateral). As the diagram below illustrates, a project relying on the combination of both equity and debt will require a lower overall return. Such a project will not only impose less risk to an equity investor, but will also allow for greater investment than only equity would allow. The equity investor will benefit from a high internal rate of return on the capital it deploys for a project. The project finance lenders will bear a portion of the risk at a lower rate of return.



H. KEY STAKEHOLDERS

The following are the key stakeholders in project finance transactions and their relationship is illustrated below:

- The project company: investor and borrower (typically an SPV)
- The sponsor (typically the borrower's shareholders)
- The Government Offtaker (grants concessions/licenses / buys products/ services generated by the project on regular basis)
- The EPC Contractor (the entity hired to construct the project)
- Fuel suppliers
- The Operation and Maintenance Contractor, who runs the project once construction has been completed.
- Other Government authorities (grant permits/rights of use)
- Lenders (typically a syndicate of banks):
 - » Commercial
 - » Multilateral/bilateral/national development banks
- Hedge providers
- Insurers
- Agents (administrative agent/collateral agents/process agents)
- Special consultants (legal counsels/independent engineer/financial consultant)



I. CREDIT ENHANCEMENTS

Governments need to create an enabling environment that facilitates the development of the host country power sector. The enabling environment may not be sufficient by itself, and therefore, to catalyze IPP deals in the market, the host country government may need to offer credit enhancements. Investors are concerned with allocating the risks of continuing payment obligations and termination payments.

- **Sovereign Guarantees.** Typically, a State’s central bank or the appropriate governmental authority guarantees the obligations of the offtaker towards the project company. The guarantee serves to insulate debt and equity investors for the duration of the project from government-related risks such as (i) political risks, (ii) changes in legislation, (iii) tax changes, (iv) bankruptcy, and (v) force majeure risks.

It should be noted that the sovereign guarantee is not a guarantee of the debt obligations owed to lenders by the project company. Governments should be cognizant of the impact of credit enhancements on their sustainable debt frameworks developed in cooperation with the IMF. Host governments have many factors to consider when determining whether to provide sovereign credit enhancements.

- **Letters of Comfort and Support.** This type of credit enhancement provides less support than a full sovereign guarantee but is not uncommon. A letter of comfort is a letter from a host country whereby it promises to facilitate a project by offering certain assurances to the project developer. Unlike a sovereign guarantee, which establishes legally binding obligations on the sovereign, a letter of comfort may be a simple reflection of willingness and intent of the sovereign to support the development of the project. Since the objective of a letter of comfort may not necessarily be to create legally binding obligations, the letter may rather seek to demonstrate the host country’s commitment to the project and offer “soft

comfort” that the host country will support the project, the project company and its sponsors. This support may include facilitating approvals required for project implementation, general support of its offtaker and fiscal incentives.

- **Put and Call Option Agreements (PCOA).** PCOAs typically deal with more significant events triggering termination, and do not provide enhancements for continuing payment obligations. A PCOA establishes two contractual obligations: the first being a put option in favor of the project shareholders to require the purchase of the assets of the power project company by government; and the second being a call option in favor of the host country to require the project shareholder to sell the assets of the power project. The PCOA also defines under which conditions the options can be exercised and defines the formula for how payments under the PCOA are to be calculated.
- **Continuing payment obligations.** These instruments can be covered by either Liquidity Letters of Credit or Liquidity Escrow accounts. They do not provide coverage for termination-related events.
- **Sponsor and subcontractor credit support.** Lenders often require sponsors to set up credit-enhancement measures that reduce some of the credit risk of these Lenders. Typically, these measures are in the form of (i) sponsor/third-party guarantees relating to the performance of the project as set out in any relevant documentation, (ii) insurance against risks relating to the project, such risks associated with construction and environmental liability, and (iii) financing facilities that allow for the use of temporarily available liquidity to handle certain risks such as local currency depreciation.

J. TARIFFS

The offtaker in a power project has obligations set forth in a PPA to make recurring payments to the power producer, broadly referred to as tariff payments. Tariff payments are the actual price the offtaker pays to the project company for capacity made available and/or energy generated.

Tariff payments are important in understanding how to finance a power project because the payment structure and components reflect a pricing of certain risks and an allocation of certain risks between the project company and offtaker. Investors will assess a tariff when evaluating the overall bankability of a deal and their consequent decision to invest in it or not and at what price or expected rate of return. Understanding a tariff is key to understanding a condition or element of a deal that may or may not drive the need for credit support.

The components of tariffs payable for a power generation facility will vary depending on a number of factors. Typical components include capacity payments and energy payments. Tariff components are often affected by whether the power plant is dispatchable, meaning whether the plant can respond to the instruction, or dispatch, of a system operator to provide or vary its power. Dispatchable technologies include gas-fired power plants, coal-fired power plants, and hydroelectric projects with

sizeable reservoirs. Non-dispatchable technologies typically include solar PV, run-of-river hydro, and wind, because they are reliant on natural conditions and, accordingly, may be intermittent. Tariffs for power projects using dispatchable technologies usually have capacity payments and energy charges; projects with non-dispatchable technologies usually only provide for the payment of energy charges. Tariffs may also vary depending on the time of use or provision of power, and there may be different calculations applicable to baseload, mid-merit, peaking, and/or self-dispatched power.

- **Capacity Payments.** A capacity payment is a monthly charge for capacity made available to the offtaker (or deemed to have been made available), regardless of whether the offtaker actually dispatches the plant. The capacity payment is structured and calculated to enable the project company to earn consistent and sufficient revenues under the PPA to enable the project company to:
 - » Pay all the fixed operations and maintenance costs and any other agreed project costs,
 - » Pay all corporate and other taxes that are assessed on the project company and its properties,
 - » Repay the project loans (and in some cases the costs of the associated infrastructure such as transmission lines), and
 - » Pay the sponsors/equity investors a return on equity.
- **Energy Payments.** Energy payments are monthly charges for the energy dispatched and actually delivered to the offtaker. It is calculated with reference to the net electrical output of the plant that is delivered to an agreed delivery point. It is usually measured in units of MWh or kWh. For dispatchable plants, energy payments are structured to allow the project company to recover the cost of inputs (such as fuel) used to generate the net output delivered and to recover operations and maintenance costs that vary depending on the quantity of net output generated. For non-dispatchable plants, the energy payment is structured to allow the project company to recover the costs a capacity payment would cover in the case of a dispatchable plant. The energy charge rate, which is the price per MWh or kWh of net electrical output, is priced to enable the project company to recover those costs over time. Typically, the project company is required to generate a specified quantity of net electrical output over a period of time (e.g., a year) in order to receive the energy charge rate. The quantity specified is typically based on a statistical probability of how much the plant should be able to produce in that period of time. For example, it may be based upon how much net output a solar PV plant is expected to generate over a year with a 90% degree of probability.
- **Deemed Energy Payments.** Non-dispatchable plants can rely on energy payments as their sole source of revenues because offtakers are generally obligated to purchase all of the energy the plants generate. In the event that (i) the project company is asked to curtail the generation of net electrical output or (ii) the plant is not capable of generating and delivering net electrical output to the delivery point as a result of risks the offtaker has agreed to assume, then the offtaker

remains obliged to pay deemed energy payments. The amount of this payment is equal to the energy payments the project company could have earned by generating net electrical output if the project company had not been asked to curtail the generation. Deemed energy payments are usually determined by calculating the quantity of net electrical output the plant could have generated during a curtailment using real-time data for the site conditions (wind speed and direction in the case of wind plants, solar irradiation in the case of solar plants, and quantities of water spilled in the case of run-of-river hydroelectric plants).

- **Pass-through Payments.** Power projects that have a separate fuel supply contract will themselves often have a take-or-pay obligation to the fuel supplier. Under a take-or-pay provision, the purchaser commits to purchase an agreed quantity of fuel over a given period of time and will be liable to pay for this quantity regardless of whether or not it actually accepts delivery of the fuel. By the same token, the supplier may have a put-or-pay obligation to compensate the power project for non-delivery of fuel. Similar provisions apply to other feedstock supply contracts. The PPAs for such power projects will typically include a provision whereby this liability is passed through to the offtaker/host government where non-delivery is caused by a risk which is assumed by the offtaker/host government. In other words, if an offtaker fails to dispatch a plant at a level that will enable the project company to consume the specified take-or-pay quantity of fuel, the offtaker (or host government, depending on the risk) will be required to make a payment to allow the project company to cover the take-or-pay payment (in part or whole, depending on the PPA provisions) to the fuel supplier.

K. INVOICING AND PAYMENTS

In order to be paid for the energy it delivers, plus any applicable capacity charge, the seller will need to periodically invoice the buyer in an amount denominated in the currency agreed in the PPA. The billing period is typically on a monthly basis. The invoice will generally include the following components: (a) capacity payment, (b) energy payment, (c) supplemental payments (including payments for any start-ups above the agreed threshold), and (d) liquidated damages and penalty amounts owed to the buyer. The buyer has the right to review the invoice prepared by the seller, and if it disagrees with the amount payable in the invoice, it may request clarification and substantiation of such invoice within a number of days agreed among the parties.

An important element after the tariff negotiation is how to measure the energy and capacity to be invoiced to the buyer. The seller is typically responsible for buying and installing meters to measure the output of the power plant. The net electrical output and capacity to be invoiced will usually be measured according to a metering code published by the regulator. The parties will agree on the meters (a main meter and a backup meter) to be used for measurements, and the delivery points for those measurements. Those meters will be regularly inspected and tested by both parties. Representatives of both parties should generally be present on the date of reading of meters for invoice.

Undisputed payments must be made in the currency agreed by the parties to the PPA.

- **Currency.** The currency of payment under the PPA is a negotiated issue that may vary in different countries. Sellers often have foreign exchange exposure in emerging markets. Foreign exchange exposure arises when a significant portion of the project costs have been financed in a foreign currency (e.g., U.S. Dollars or Euros). If the seller is to be paid by the buyer in the local currency, it must ensure that it can pay back the lenders in the foreign currency.

The currency of payment will often depend on the strength of the local currency as well as the convertibility of the currency. In situations where the local currency has a long history of stability and is generally regarded as being able to maintain this stability, the PPA will likely be payable in local currency.

In other markets without this stable history it is accomplished by: 1) benchmarking the amount of the buyer's payment in local currency to the foreign currency at the market exchange rate or 2) the buyer paying the seller directly in a foreign currency.

As an alternative, the tariff may include a more structured foreign currency indexation formula. The indexation formula is used in cases where the seller can "hedge" the foreign exchange exposure. Hedging is generally available in markets where the local currency markets are highly liquid.

- **Method of payment.** The method of payment is subject to agreement of the parties, but is often by wire transfer to a designated account of the seller.
- **Disputed amounts.** Normally, if any portion of the invoiced amounts are disputed by the buyer, these will be withheld from payment and contested as part of the agreed dispute resolution mechanism under the PPA. An interest rate will apply to all such withheld amounts which must be added to the payment as determined under the dispute resolution mechanism to be owed to the seller. In some cases, the parties may agree that the amounts representing the disputed portions of the invoice will be put in an escrow account until resolution of the dispute.
- **Late payment.** Any late payments (i.e., payments made after the due date agreed between the parties) will bear interest at an interest rate (either local interest rate or foreign interest rate) agreed between parties from the date on which the payment was due until the date the payment is made. The basis of the interest rate is generally the interbank rate for the monetary market published by the central bank of the country for local currency components or the LIBOR/EURIBOR for US/EUR foreign currency components.

L. TAXATION/INVESTMENT LAW

The Iraqi legal regime governing investment in Iraq consists of several related laws on establishing a project, including: Residency Law No. 118 of 1978, Companies Law No. 21 of 1997, as amended, Trade Law No. 30 of 1984, and Banking Law No. 94 of 2004, Civil Law No. 40 of 1951, Investment Law on Crude Oil Refining No.

64 of 2007, Industrial Investment Law No. 20 of 1998, and Free Trade Zone Law No. 3 of 1998, in addition to several related pieces of legislation, such as Regulation No. 5 of 1989.

Three points should be noted regarding these related laws:

First, when the text of any of these laws conflicts with the National Investment Law, application of the National Investment Law supersedes these laws, even if the conflicting law was enacted subsequent to the National Investment Law. This is pursuant to the principle that “specific rules restrict general rules,” and is also affirmed in the National Investment Law, which states that “any provision that contradicts the regulations of this law shall be null and void.”

Second, the general policy of the State is toward ensuring that investments are given priority. This is a critical point in terms of the application of related laws, drafting contracts, and removing ambiguities in applying laws and procedures.

While the National Investment Law lays out the general terms for providing benefits and protections for investors, there are areas on which the National Investment Law is silent and the relevant laws outline more detailed procedures to be followed by the investor. At the same time, the National Investment Law does not absolve any investor from fully adhering to the requirements and mechanisms of other laws, as well as any legal requirements applicable under Iraqi law as a whole. For example, obtaining an investment license does not absolve a project investor from satisfying the requirements for registering a company under the Companies Law, nor from registering or satisfying the particular requirements for obtaining a building permit or import license. Moreover, while the National Investment Law provides exemptions for investors from paying income tax for a specified number of years, it does not exempt investors from submitting the required financial disclosures to the tax and regulatory authorities in Iraq, as required by Iraqi Income Tax Law No. 113 of 1982.

Third, it is noteworthy that Iraq is in the process of joining multilateral and bilateral agreements that regulate investment activities, as a means of providing additional privileges to investors. Once such agreements are joined and acceded to by the GoI, they will supersede local legislation and should be taken into consideration by those concerned with the drafting of investment contracts as providing an alternative means of recourse.

M. COLLATERAL SECURITY/SECURED TRANSACTIONS

Collateral security protects the lender in the event the borrower fails to perform its repayment obligations. The lender essentially holds an interest in the borrower’s property to secure a loan or obligation. Assets of the project and/or the sponsors are assessed to impose a charge, either in the form of a mortgage, pledge, hypothecation, lien, or other type of encumbrance used as collateral, which may be supplemented by guarantees and assignment of rights (whether individual, corporate, or sovereign). In the event of default, the lender is entitled to liquidate charged assets.

Secured transactions provide many benefits for power project borrowers and lenders. For example, they make lower cost credit available to finance the project by making secured credit more available. They also allow the project company to use the full value inherent in its assets to support its credit. Secured transactions laws also enable borrowers and lenders to obtain security rights in a simple and efficient manner, provide equal treatment of diverse sources of credit and of diverse forms of secured transactions, and help establish clear and predictable priority rules. The UNCITRAL Legislative Guide on Secured Transactions provides an international framework of workable laws for secured transactions.¹³³ The key to secured transactions is that collateral increases the level of credit available to a project borrower and decreases the cost of that credit, while also providing a measure of security for a lender.

N. POWER PROJECT FINANCE AND PPPS IN IRAQ – PATH TO EXECUTION

Restoring a business-friendly atmosphere in Iraq is a building-block process that involves the use of DFIs, ECAs, Iraqi, and other regional banks. DFIs in particular play a key role in demonstrating confidence in the new regulatory and economic environment as well as in mitigating political risk to the project. Given the importance of DFIs, ECAs, and international banks (mainly under ECA cover) in the financing plan, projects will have to demonstrate compliance with local and international environmental regulations, the Equator Principles,¹³⁴ and the environmental and social policies of lenders, which frequently include the IFC Performance Standards on Environmental and Social Sustainability and the World Bank Group Environmental, Health, and Safety (EHS) Guidelines.

Iraqi banks may have interest in limited recourse projects but may not be willing or have the capacity to fund the entire project, compelling foreign and domestic investors to obtain senior and subordinated debt from multiple sources. Collectively, the DFIs, ECAs, and Iraqi banks will lend credibility to a project and will be instrumental in providing assurance to international banks that the Iraqi MoF is committed to adhering to international best practices and mitigating risks.

Project financing fundraising requires diversification and optimization of liquid sources. It will be driven by the terms of the draft PPA, with a MoF Guarantee that is confirmed by the MoF. Another important source of funding in the financing plan comes from the involvement of the local and regional banks for policy reasons, which

¹³³ See United Nations Comm'n on Int'l Trade Law, *UNCITRAL Legislative Guide on Secured Transactions*, available at https://www.uncitral.org/pdf/english/texts/security-lg/e/09-82670_Ebook-Guide_09-04-10English.pdf. For more information on secured transactions, and the laws that make these security arrangements possible and workable, see Heywood Fleisig, *Secured Transactions: The Power of Collateral*, available at <https://www.imf.org/external/pubs/ft/fandd/1996/06/pdf/fleisig.pdf>; Int'l Fin. Corp., *Secured Transactions and Collateral Registries*, available at <http://www.ifc.org/wps/wcm/connect/793e79804ac10ff9ea69e4220e715ad/Secured+Transactions+and+Collateral+Registries+Brochure-English.pdf?MOD=AJPERES>; and The World Bank, *Principles for Effective Insolvency and Creditor/Debtor Regimes*, available at <http://pubdocs.worldbank.org/en/998191463585986043/ICR-Principles-Insolvency-Creditor-Debtor-Regimes-2015.pdf>.

¹³⁴ The Equator Principles is a framework adopted by various financial institutions for assessing and managing the environmental and social risks of projects. For a list of the financial institutions that have adopted the Equator Principles, see *Equator Principles Association Members & Reporting*, available at <http://equator-principles.com/index.php/members-and-reporting>. For an overview of the requirements under the Equator Principles for project financing, see *The Equator Principles* (Jun. 2013), available at http://equator-principles.com/resources/equator_principles_III.pdf.

could significantly enlarge the pool of liquidity for a given project. The capacity of Iraqi banks to lend in U.S. dollars over long periods will have to be assessed. As a final assessment of liquidity, the total amount of debt for a project and its impact on the overall financial structure will be determined (i.e., Debt-to-Equity ratio, timing of future phases, etc.).

The limited headroom in the financing sources as well as the Iraqi sovereign credit rating is likely to result in suboptimal debt pricing levels as compared to the low market pricing seen on recent IPP projects in the MENA region. These levels are, however, subject to change as political risk and credit rating improve.

The illustration below distills the information above into a simple, step-by-step approach to setting up a project in Iraq:



	DBFO projects (EPC + [X]y O&M)	BOO / BOOT (IPP) projects
Construction	Risk borne by EPC Provider Milestone Payments by MOE during construction	Risk borne by EPC Provider / IPP Sponsors No payments for MOE before PCOD
Equity	MOE Equity Exposure [ca. X%]	No Equity Exposure for MOE
Debt	MOE borrowing with MoF Guarantee on Debt Debt on MOE Balance Sheet Important impact on sovereign borrowing limits	Project Company borrowing with MoF Guarantee on PPA payments only Debt on project Company Balance Sheet
Technical Solution	Limited technical due diligence by MOE	Extensive independent due diligence by MOE, Sponsors and Lenders given non-recourse structure
Plant Performance • Dependable Capacity • Heat Rate • Degradation	Risk born by MOE Guaranteed only at PCOD [Limited Guarantee until PCOD + 5 years] Debt service and Fixed O&M costs (after transfer) to be paid regardless of availability	Risk born by IPP Sponsors Guaranteed degradation for [X] years Capacity and Fixed O&M Payments paid against availability (owner and lenders take performance risk)
O&M • Availability • O&M Costs • Admin Costs	Risk born by MOE [after initial O&M period] Provided for [X] years + MOE O&M afterwards Likely Limited Liability for original O&M Provider Admin cost for MOE High	Risk born by IPP Sponsors Provided for long-term by world class operators Full Liability on Sponsors with Equity Risk Admin cost for MOE Low
Fuel Supply Risk	Risk born by MOE	Risk can be transferred to IPP Sponsors Extensive experience of IPP Sponsors

TYPE	DESCRIPTION	TYPE OF ASSET	FUNCTIONS TRANSFERRED	PAYMENT MECHANISM
Build-Own- Operate-Transfer (BOOT)	BOOT is often used interchangeably with BOT. However, a BOOT project typically has a much longer tenor than a BOT project.	New infrastructure	Typically, design, build, finance, maintain, and some or all operations; BOOT always includes private finance	Can be either government or user pays
Build-Own-Operate (BOO)	Ownership of the project usually remains with the project company. Therefore, the private company gets the benefits of any residual value of the project. This framework is used when the physical life of the project coincides with the concession period. A BOO scheme involves large amounts of finance and long payback period.	New Infrastructure	Design, build, finance, maintain all operations	Can be either government or user pays
Build-Operate-Transfer (BOT) / Build- Transfer-Operate (BTO)	This approach to describing PPPs for new assets captures legal ownership and control of the project assets. Under a BOT project, the private company owns the project assets until they are transferred at the end of the contract. In contrast, a Build-Transfer Operate (BTO) contract, asset ownership is transferred once construction is complete. Ownership rights mainly affect how handover of assets is managed at the end of the contract.	New infrastructure	Typically, design, build, finance, maintain, and some or all operations; under some definitions, BOT or BTO may not include private finance, whereas BOOT always includes private finance	Can be either government or user pays
Rehabilitate-Operate-Transfer (ROT)	In either of the naming conventions described above, “Rehabilitate” may take the place of “Build” where the private party is responsible for rehabilitating, upgrading, or extending existing assets.	Existing infrastructure	As above, but “rehabilitate” instead of “build”	Can be either government or user pays
Design-Build-Finance-Operate-Maintain (DBFOM); Design-Build-Finance- Operate (DBFO); Design-Construct- Manage-Finance (DCMF)	Under this nomenclature, the range of PPP contract types is described by the functions transferred to the private sector. The “maintain” function may be left out of the description (so instead of DBFOM, a contract transferring all those functions may simply be described as DBFO, with responsibility for maintenance implied as part of operations). An alternative description along similar lines is Design-Construct-Manage-Finance (DCMF), which is equivalent to a DBFOM contract.	New infrastructure	As captured by contract name	Can be either government or user pays
Operations and Maintenance (O&M)	O&M contracts for existing assets may come under the definition of PPP where these are performance-based, and long-term contracts (sometimes also called performance-based maintenance contracts).	Existing infrastructure	Operations and maintenance	Government pays

CHAPTER IV. NEGOTIATING AND DRAFTING THE POWER PURCHASE AGREEMENT AND OTHER PROJECT AGREEMENTS

A. INTRODUCTION

This chapter provides an in-depth analysis of the agreements at the core of power project transactions, most notably the PPA. An overview of issues relating to the financing and bankability of a project is also provided, in addition to other considerations relating to the drafting and negotiation of such transactions.

B. THE POWER PURCHASE AGREEMENT

1. WHAT IS A PPA?

The agreement that governs the sale and purchase of power is known as a PPA.

A PPA is a contract between two parties, one who produces or generates power for sale (the seller/producer/project company) and one who seeks to purchase power (the buyer/offtaker). This contract is sometimes referred to as an offtake agreement.

2. ORIGINS OF A PPA

A PPA is merely an instrument intended to facilitate the sale and purchase of electrical power. As such, it only comes into being once the prospective buyer (the offtaker) has made a series of critical decisions. These decisions can include the need for power, the available sources of power, the buyer's economic ability to purchase power, the power generating technology desired, and the location of the power plant.

a. Power Demand

Before anything else, the offtaker will need to assure itself of the demand for power. A study will need to be undertaken to ascertain not only current power demand, but also any anticipated fluctuations in demand over time.

b. Budget and Technology

After identifying the need for power, the offtaker must identify potential sources of power. This determination will depend on the approximate tariff at which it can afford to purchase power and the fuel and technology to be used. The determination regarding the offtaker's budget will go hand-in-hand with the selection of power-generating technology. Certain technologies are more expensive than others, but may be desirable due to their ability to supplement their power sources when demand is greatest, or because of their perceived environmental benefits. Government policy on the appropriate overall energy mix for the country may also affect the decision.

c. Location

The offtaker will then need to determine where the power source should be located. The location is typically determined on the basis of which regions of the country

need additional power and proximity to transmission and distribution lines. If possible, the location will be near substations and transmission lines that can carry that power most efficiently to the end-user. Ultimately, offtakers (and producers) will want to locate the power source as close as possible to a connection point on the power grid to avoid the cost and risk of building transmission infrastructure, with the subsequent result of transmission line losses. Other equally important issues that will determine location are as follows: easy access to the fuel source to the plant, the potential social and environmental impact of any power plant on local communities, and whether efficient or low-cost mitigants are available. A gas-fired power plant, for example, would be of little use in a remote area where there is not an economically efficient source of gas. Certain renewable energy resources, such as solar or wind, may be more appropriate for remote locations and will have the added benefit of not adding to carbon emissions. These power sources, however, do not offer the same predictability of thermal power sources (both wind and solar are by nature more unpredictable power sources). The choice of power generating technology is an important one for the offtaker. It will have a direct impact on the cost and reliability of power, as well as the environmental and social impacts of the project.

C. POWER PROCUREMENT AND TARIFF CONSIDERATIONS

Armed with the knowledge gained from making these decisions, the offtaker will be able to reach out to market participants to seek solicitations of interest and price estimates. There are generally two ways in which this can be done.

The more common method is via a solicited bid that takes the form of a competitive procurement process. This will often involve a formal request for proposals (RfP) which will identify, among other things, the amount of power being sought, the generation technology to be used, and the area where the power is needed. Using this information, producers will bid against each other to highlight their qualifications, their ability to pay for the upfront cost of building the power plant, and to offer the best tariff within their capability. The offtaker will compare prices, financial capacity and qualifications to ensure that the chosen proposal obtains a source of power that will function reliably over time at a price that is most advantageous to the end-user. This method is generally seen as producing a more effective result than engaging in direct negotiations with interested producers who put forward unsolicited proposals.

Unsolicited proposals are sometimes utilized as a means of quickly procuring power to deal with emergency situations, and hastening power generation in countries with large power deficits. This process is also utilized in jurisdictions where there are no frameworks in place for competitive bidding. It is important to have adequate regulatory safeguards to ensure transparency and value for money in comparison to unsolicited proposals.

1. PUTTING PEN TO PAPER

In competitive bidding, the draft PPA is sometimes included in the RFPs package to enable prospective bidders to ensure that project risk allocations are given due consideration in the submissions of their bids. In unsolicited proposals, by comparison, the offtaker has the option to provide a draft PPA to the producer after satisfactory due diligence to ascertain the viability and feasibility of the proposal.

The first draft of the PPA can sometimes come from the producer. However, as the offtaker is seeking to purchase the power and will be relying on the document for years to come, it is advisable for the offtaker to take responsibility for preparing the initial draft PPA with the assistance of qualified legal counsel. Many multilateral and bilateral development institutions have financing available to government entity offtakers to hire qualified legal counsel.

2. NEGOTIATION AND FINALIZATION

The draft PPA will include key items such as tariff, technology, and location. It will also address a number of other issues that the parties will negotiate and agree upon.

It bears noting that during the negotiation process it is advisable for both parties to engage knowledgeable legal counsel, technical advisors, and financial consultants, unless sufficient resources exist in-house. The parties will benefit from the advice of these consultants in determining which risks and obligations are properly allocated to each party. This is an iterative process that will allow each of the parties to better understand the transaction they are entering into, with the goal of arriving at an agreement that both parties can ultimately execute and abide by.

D. OVERVIEW OF PPA OBLIGATIONS

The main obligation of the buyer under the PPA is to pay the agreed tariff when due. The seller's primary responsibilities are to build, operate, and maintain the power plant in accordance with the requirements of the PPA and applicable law, and deliver the agreed amount of power in accordance with the PPA. However, the parties' obligations do not stop there.

Additional obligations relate primarily to the need for: (i) payment and performance security; (ii) transmission of power and interconnection to the grid; (iii) arrangements with lenders; (iv) consents, permits, approvals, and licenses; (v) rights to the land on which the power plant and/or transmission lines will be located; and (vi) insurance.

For the most part, these obligations do not fall solely on one party, but are often shared by parties or will shift from one party to another based on the circumstances surrounding the power plant and where it is located.

	BUYER	SELLER
Primary Obligations	Make payment	Build and operate power plant; deliver agreed energy
Security	Payment security	Performance security
Transmission/ Interconnection	Transmission/Interconnection (bundled and some unbundled)	Transmission/ Interconnection (some bundled)
Arrangements with Lenders	Direct Agreement	Financing
Permits	Assistance with permits/certain buyer approvals	Obtaining permits
Land	Grant of land/assistance with obtaining land	Obtaining land
Insurance	Force majeure, business interruption	Force majeure, currency, etc.
Local Content	N/A	Labor, materials, equipment
Decommission	N/A	Decommission, clean-up

E. TIMING REQUIREMENTS TO CONSIDER

There are usually various timing requirements in a PPA that both the producer and the offtaker need to keep in mind. Both parties need to make sure they are comfortable with the timing requirements and the consequences if they fail to meet their deadlines for these requirements under the PPA.

These include:

- Effective date of the PPA
- Time for satisfying conditions precedent and attaining financial close under any related financing
- Time for testing the plant units for ascertaining the Commercial Operations Date (COD)
- Date for completing interconnection facilities and related facilities
- Time for fuel supply connection to the plant
- Fuel supply start date
- Time for submission and payment of invoices
- Time for conducting capacity tests
- Cure periods for various breaches
- Time to serve termination notices
- Dispute resolution timelines

There is also a need to ensure that the various timing elements are properly aligned. For instance, the interconnection date and the fuel supply start date need to occur before the COD.

F. FINANCING OF POWER PROJECTS

1. BANKABILITY

Bankability refers to whether a project will be acceptable to lenders and refers to the scope of consideration of a project seeking project financing in the lending market. A project can be financed by ECAs, DFIs, commercial banks, and private equity funds. Therefore, bankability can also be thought of as the ability to attract financing from multiple source of funds rather than limiting it to one particular source.

2. THE ROLE OF THE PPA IN BANKABILITY

While all of the other project agreements listed in the paragraphs below are important to bankability, the PPA is often seen as the key to any bankability analysis. For the typical power project, there is only one stream of revenue – payments from the buyer under the PPA. If the buyer fails to pay, it will be very difficult for the project to repay its lenders on a timely basis.

The PPA also helps to accommodate the unique nature of power projects. Power generation is unique in that the electricity generated is being sold into a geographically limited, and often highly regulated, market. As opposed to other high-value commodities like hydrocarbons, minerals, or precious metals that can be transported to meet demand, the power project is beholden to the demand of the market that it serves.

Similarly, the pricing of electricity to end-users in emerging markets is often guided by regulation rather than by market forces. The PPA is essential as it addresses the uncertainty in demand and in pricing. In respect to the demand, the PPA establishes a long-term purchase obligation that provides a consistent revenue stream to the producer and a consistent flow of electricity to the offtaker. On the pricing side, the PPA incorporates a tariff formula that is tailored to the technology, operations, and debt characteristics of the project, which can be modeled over the full life of the project. This allows the PPA to establish an electricity price that reflects the true cost of generating the power.

For projects being financed by third-party lenders, before a PPA can truly be deemed final, the lenders will need to be comfortable with the PPA. Although typically not a party to the PPA, the lenders financing the producer's up front costs will want to assure themselves that the documentation governing the availability of revenue to repay their loan – i.e., the PPA – is satisfactory to them. The lenders will therefore seek to clarify or even modify provisions in the PPA to grant them greater comfort regarding the ability of their borrower (i.e., the producer) to rely on the PPA as a source of repayment of their loan. The lenders will seek to make clarifications or modifications to the PPA even if it has been signed. Such amendment could be contained in an addendum to the PPA or contained in a document referred to as a “direct agreement.” This direct agreement will be entered into by the offtaker, the

producer, and the lenders, and may include any amendments to the PPA required by the lenders, as well as certain provisions related to the offtaker's consent to the producer's collateral or conditional assignment of the PPA to the lenders in a default scenario and the lenders' step-in rights.

3. RISKS TO BANKABILITY

In the typical power project financing, the only financial return to lenders is the repayment of the project debt and the payment of interest rates (along with certain agreed-upon fees). However, since debt providers have large capital outlays at risk and depend exclusively on revenues from the project for repayment, the lenders will insist that the project sponsors and documents are strong enough for the project to reach commercial operations. The lenders, like all of the parties, want to avoid a catastrophic scenario where the project fails completely, especially during the construction phase of the project. At operations, the overarching concern is ensuring that revenues are adequate to service debt.

The following are some of the key considerations which, if not sufficiently covered, will make a project unlikely to receive debt financing:

- **Term:** The term of the PPA should be long enough to allow the debt to be repaid, and if the debt is not fully amortized (in other words, if there will be any principal amount outstanding at maturity) the term of the PPA should be long enough to support a refinancing of the remaining debt.
- **Tariff:** Lenders will require certainty with respect to the tariff payable under the PPA.
- **Changes in Law and Tax:** Lenders are not in a position to take any risk related to changes in law or taxes over the life of the project.
- **Offtaker Creditworthiness:** If the offtaker is not sufficiently creditworthy, lenders will require other broad forms of credit support that create additional costs and complications for the project. Even in developed markets, many offtakers are not sufficiently creditworthy to create a financeable project.
- **Sponsor Quality:** The lender and offtaker will consider the experience, reputation and financial strength of the owners of the SPV.
- **Billing and Payment:** The billing period from the offtaker to the producer should be frequent enough (monthly or even bi-weekly) to minimize the level of unpaid energy and ensure that the schedule of debt service payments are adhered to. It also alerts the lenders to potential payment/liquidity issues.
- **Currency/Calculation:** PPA payments and calculations are most often made in the same currency as that needed to repay the debt. If not, there will need to be a plan for foreign exchange hedging and/or exchange rate indexation and a true-up mechanism. In addition, are there any convertibility issues with the payment currency? If so, the lenders may require payment to be made in a different currency, or the offtaker or the host government will need to guarantee conversion.

- **Termination:** Lenders do not want the offtaker to be able to escape the long-term purchase obligation under the PPA, since this would leave the project without any revenue to service the project debt. Lenders will pay particular attention to ensure that seller events of default and force majeure events do not allow the offtaker to prematurely terminate the project. If termination does occur, lenders will also want assurances that the project debt will be satisfied.
- **Remedies upon Buyer Events of Default:** In particular, lenders need the seller to have the ability to exercise certain rights, even up to PPA termination, if the offtaker is failing to make payments or fails to deliver the required payment security.
- **Lenders Rights:** Lenders will typically make provision for step-in rights and for taking a security interest over project assets via the loan and direct agreements.

While the above can provide some useful guidelines, ultimately, bankability is an ever-changing concept. What the lending market accepts (or demands) today may be different from what it will accept (or demand) in the near and distant future. Given the technology, size, scope, volume, and geographical location of power projects, it can be very difficult to ascertain what is truly “market” (i.e., consistent with terms you generally see market participants accepting). Moreover, an experienced developer or sponsor may be better able to persuade lenders to accept provisions that are more friendly to the project company. Alternatively, lenders may be happy to live with a particular provision or risk at the project level, as long as they have a guarantee or other form of credit support (from either the sponsor or offtaker) to cover that risk.

Finally, it is worth noting that some power markets, particularly in developed countries, are sufficiently mature that PPAs are not even required to make a project bankable. This is often the case with merchant power plants (those that do not benefit from a dedicated buyer) where a project can be developed on the basis of independent reports indicating the existence of sufficient expected spot market demand. Once the project is completed, the plant will simply sell into the spot market. However, even in the most developed markets, the absence of a long-term PPA can result in higher interest rates for the project. A conventionally bankable PPA remains an essential tool in virtually every market and ideal in energy markets in developing countries.

G. OTHER PROJECT AND FINANCING AGREEMENTS

While the PPA governs the sale and purchase of power, there are a number of related contracts that interplay and relate to the financing, building, and operation of the power plant. These agreements must be aligned with the PPA to ensure fair apportionment of risks.

Additionally, each of the counterparties to the Engineering, Procurement and Construction Contract (EPC Contract) and the Operating and Maintenance Agreement (O&M Agreement) / Long-Term Service Agreement (LTSA) will need to be familiar with, and agree to abide by, the terms in the PPA relating to the design, construction, operation, and maintenance of the power plant.

The following are some of the related project agreements typically necessary for a power project:

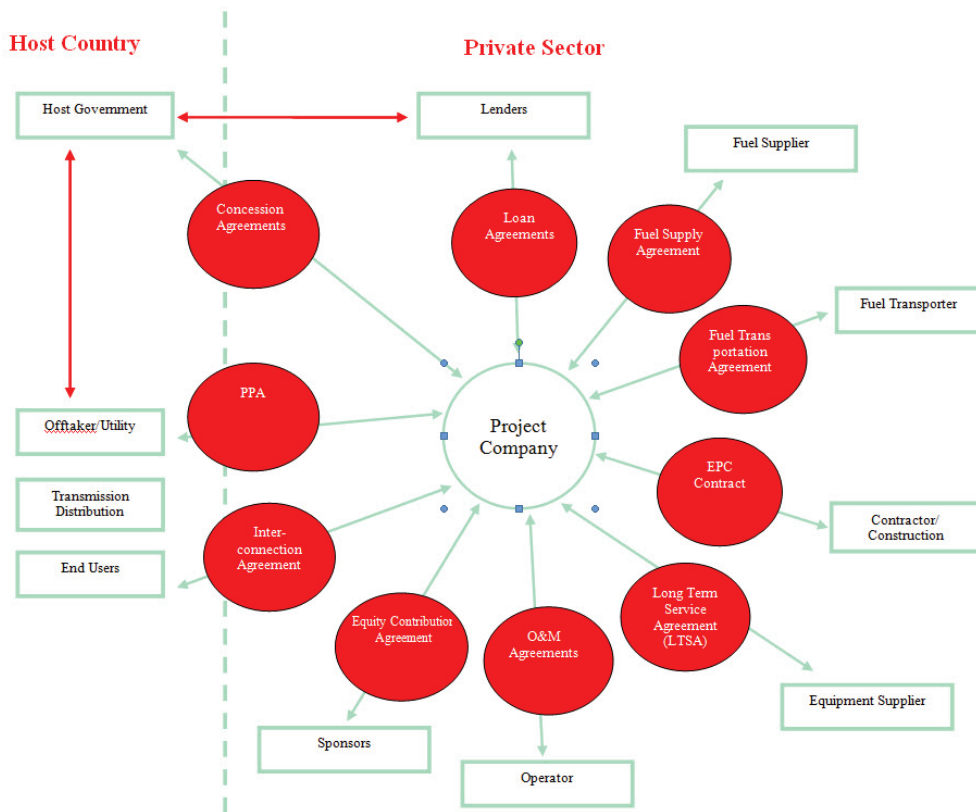
- **Concession/Implementation Agreement:** Grants the producer the right to develop, finance, construct, and operate the power plant, including the right to sell power to the offtaker. The commissioning government will undertake to ensure the granting of requisite approvals and consents for the project to ensure that no part of the project is nationalized or expropriated, and may also agree to guarantee the performance of the offtaker's obligations under the PPA (if not separately set out in a Sovereign Support Agreement). The producer will undertake to apply for all requisite approvals and to proceed with the development, construction, and operation of the power plant in accordance with the PPA.
- **Grid Interconnection Agreement:** Governs the connection of the power plant with the power grid. In addition to setting out connection charges and conditions, the Interconnection Agreement sets the capacity levels (for connection and transmission) and conditions for outages.
- **Fuel Supply Agreements/Bulk Supply Agreement:** Where relevant, establishes the availability of fuel supply and quality. The quantity of fuel supplied shall be as notified by the producer. The Supply Agreement will provide for the passing of title and risk (upon delivery of the fuel) and details of the delivery facilities. Provisions will also be included for interruption to supply or variation in specification of supplied fuel.
- **Fuel Transportation Agreement:** Provides for transporting the fuel from the fuel supplier to the power plant.
- **EPC Contract:** Sets the terms and conditions for the design of the power plant, the procurement of materials and equipment, and the construction of the power plant. The obligations created under this agreement can also be divided among multiple contracts that include one or more of these scopes. The EPC Contract will provide for fixing of the contract price and completion date and provide for liquidated damages payable in the event of delays or failure to meet certain performance criteria and guarantees. The EPC Contract will also provide for the Contractor to obtain access to the transmission grid (ensuring that the infrastructure is in place and that the power producer is permitted to export power). Certain provisions from the PPA, such as the commissioning and testing, are typically mirrored (incorporated) in the EPC Contract.
- **O&M Agreement:** Governs the rights and responsibilities of the entity that will operate the plant and be responsible for its maintenance.
- **LTSA:** Provides for servicing the plant at regular intervals during the operation of the PPA.

If the power project is financed, relevant financing documents may include:

- **Loan Agreement:** Creates the obligation of the lender to make a loan to the producer to finance the power plant, as well as the obligations of the producer/borrower to comply with various covenants in the agreement.

- **Collateral Security Documents:** Local and offshore security documents, including share pledges, mortgages, assignments of asset, intellectual property and contract rights, account control agreements, etc., sufficient to enable the lender to step into the shoes of the borrower.
- **Completion Guaranty:** Obligates the owners of the power plant to complete the project by a date certain or repay the loan.
- **Equity Contribution Agreement:** Obligates the owners of the power plant to make equity or subordinated debt contributions to finance the portion of the power plant not being financed by third-party lenders.
- **Sovereign Support Agreement:** May include sovereign guarantees, comfort letters, put-and-call options, and other forms of sovereign support that enhance the creditworthiness of the offtaker and other governmental entities involved in the project.
- **Credit Support Agreement:** May include PRGs, letters of credit and bank guarantees from commercial banks, escrow agreements, and sponsor support.
- **Direct Agreement:** Governs the relationship between the lenders and the parties involved in the project.

The following chart illustrates the relationships between the different types of agreements:



CHAPTER V. RISK ALLOCATION/MITIGATION & GENERAL CONTRACTUAL TERMS: IRAQ-SPECIFIC CONTEXT

A. INTRODUCTION

This chapter seeks to explore the key risks that arise in the context of a PPA with a focus on Iraq. The risks outlined here are not exhaustive. Risks and methods for their mitigation may also vary from project to project, depending on where the project is located, the underlying regulatory framework, the structure of the offtaker, and the particular generation technology, among other considerations.

B. TYPOLOGY OF RISKS

The foundation of a successful and bankable PPA (and the power project as a whole) is the achievement of an equitable balance and allocation of risks among the contracting parties to the PPA. The age-old principal of contractual risk allocation in project financing is especially true for PPAs – risks should optimally be allocated to the party best able to manage such risk.

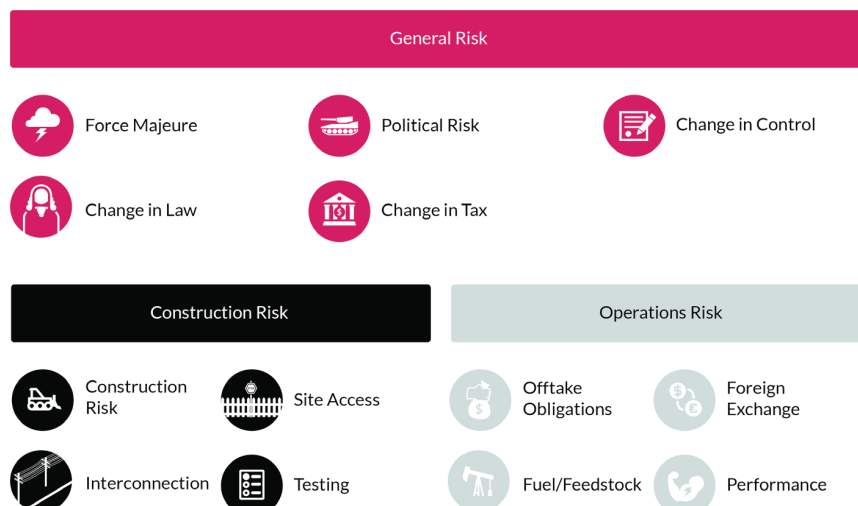
In the case of most power projects, there are two principal risk takers who must agree on the allocation and pricing of risk: (i) the offtaker, typically a government-owned power utility, and (ii) the sponsors, representing the project investors in the project company. Lenders and other financing providers (such as letter-of-credit issuing banks and hedge providers) also actively participate in the risk allocation process as they effectively become exposed to all of the allocated risks through their financing. Other risks may also be shifted, to some extent, to insurers and other project participants, though at a cost to the project.

In some cases, third parties are in the best position to manage some of the risks associated with the power project. Such parties may include, for example, the contractor who has been appointed to undertake the construction of the power plant or the transmission company responsible for building the interconnection facilities.

These third parties are not generally parties to the PPA, yet the risk must be allocated to one of the parties to the PPA, so the project parties must consider how to mitigate such risks. There are scenarios where a party that may not necessarily control a risk is nonetheless willing to take it for the right economic benefit or simply to get a project financed. For example, a government seeking to attract greater private sector investment may agree to a lower tariff in exchange for assuming certain risks outside of its control. For instance, even if the offtaker has no direct control over the government fuel supply entity, it may agree to take the risk of fuel supply with a view to attracting investment. If a project sponsor agrees to take a risk outside of its control, it may seek a tariff which in turn results in a higher return for its investors. In this event, a party to the PPA would assume the risk under the PPA and may seek back-to-back provisions in both the PPA and third-party contracts in order to effectively pass the risk onto the third party.

There is, however, a limit to the extent to which parties can shift risk. Ultimately, the allocation of risk must still result in a bankable and viable project. An appropriate balancing and allocation of risk in a PPA should aim to provide sufficient incentive to the contracting parties to perform their obligations under the PPA.

Some risks are present throughout all phases of a project. Certain risks arise only during the development and construction phase, while others arise only once the project is operational.



1. DEVELOPMENT & CONSTRUCTION PHASE RISKS: PRE-CONSTRUCTION RISKS

a. Land Procurement

The project company will typically bear the primary responsibility to procure the land on which the power plant will be developed and operated. To the extent that the offtaker and/or government owns, leases, or grants a concession over such land, and is making such land available to the project company, then the responsibility may sit more appropriately with the offtaker or another government entity, such as the MoF.

Similarly, where a government authority or government-controlled offtaker entity is the lessor of the project site, the project company will often seek additional comfort from the government with respect to such lessor's compliance with the terms of the relevant lease arrangement. In some instances, the offtaker may still be called upon to assist the project company in obtaining such rights, especially where private landowners are unwilling to sell their land and the government can use its right of expropriation or eminent domain (the right of a sovereign or its agencies to acquire private property for public use in exchange for fair compensation). It is in the interest of both the offtaker and the project company to ensure that the right to occupy the project site is secured for the entire term of the PPA. If the term of the PPA can be renewed, then the right to occupy the project site should be secured for the extension period.

In Iraq, most projects are likely to be located on land owned by either the MoE, the MoF, or local municipal authorities. Land is usually provided to the project company under a *musataha*, a specific type of long-term arrangements that allows its holder to lease land for a long period. A *musataha* can be registered with the Real Estate registrar and is recognized as a transferable right in rem by the MoF. For projects operating under the National Investment Law, the NIC assists the project company in obtaining these rights for projects that generate at least 30MW of power, while for investment projects that generate less than 30MW, the PIC will assist in obtaining these land rights, in each case to the extent not directly obtained from the MoE.¹³⁵

b. Failure to Commence Construction

The offtaker will want reassurance that the project company will commence construction activity within a minimum period of time after the effective date of the PPA. Although the failure to commence construction may not be a direct result of the project company's acts, such as when an EPC contractor fails to execute its duties under the EPC Contract, the potential liabilities associated with this form of default still rest entirely with the project company. Failure to commence construction within the defined time period will either cause the PPA to terminate automatically, or give the offtaker the right to terminate the PPA. The project company's failure to commence construction may also trigger payouts under construction or performance bonds.

There are often limited opportunities for a project company to cure a failure to commence construction. Some PPAs may provide the project company with the option to extend the commencement period, while at the same time paying liquidated damages to remedy the initial delay. If the delay is caused by a force majeure event (including a political force majeure event) or by a default by the offtaker (or any related party or governmental authority under any other project contracts), the time limit for commencement of construction will be extended day-for-day. This extension will continue so long as the relevant force majeure event or default prevents the project company from commencing construction.

For projects governed by the National Investment Law, delays attributable to the project company are subject to penalties calculated on a daily basis.

c. Construction Risks: Abandonment

Following commencement of construction, the offtaker will also want to be sure that construction proceeds as planned and that the project will not be abandoned. Abandonment could take the form of a permanent suspension of the project's construction or operation, or could occur via constructive abandonment, where construction or operation has been suspended for a protracted period of time. In either case, abandonment of the project will constitute an event of default by the project company, entitling the offtaker to terminate the PPA. After the project is operational, the concept of abandonment and the applicable time period will vary (depending on the technology of the project) in order to account for different levels of intensity of the operation (for example, active management of a thermal plant versus passive management of a solar installation).

¹³⁵ See Investment Regulation No. 2 for 2009, art. 4 second (Iraq).

For projects that are not governed by the National Investment Law, the party responsible for the default will pay compensation. For projects governed by the National Investment Law, defaulting project companies are subject to penalties (calculated on a daily basis), government withdrawal, and liquidation of the project.

d. Delays in Achieving the Commercial Operation Date (COD)

Construction of the power plant within an agreed time schedule is one of the primary obligations of the project company under the PPA. Accordingly, failure to complete the plant (i.e., achieve COD) within the applicable timeframe will, in the absence of force majeure or other relief events, constitute a breach of the PPA, entitling the offtaker to claim liquidated damages for delay and/or ultimately to terminate the PPA. The project company will in turn need to ensure that any obligation to pay delay liquidated damages is passed through to the EPC contractor under the EPC Contract (in which liquidated damages for delay will need to be sized to cover not only those payable under the PPA, but also debt service under the loan documents). The EPC Contract should also provide that, upon termination of the PPA for prolonged delay, the project company is entitled to terminate the EPC Contract and claim appropriate compensation.

e. Deemed Completion

There are a number of circumstances in which the project company (and its contractors) must be entitled to claim relief for delays. Relief may be given with respect to time only (i.e., the project company is given a time extension only), or both time and money, through the concept of “deemed completion.” Deemed completion occurs where completion is not achieved, as a result of risks for which the offtaker (and/or government) bears the risk. In such circumstances, deemed completion will typically be held to have occurred on the later of the relevant scheduled completion date and the date on which the plant would, but for the relevant risk event, have occurred. Upon deemed completion, the offtaker will be entitled to receive capacity payments (or deemed energy payments) sized by reference to the contracted capacity of the power plant. Thereafter, following completion testing, if the plant performance tests demonstrate a lower-than-contracted capacity, the project company will typically need to account for the difference.

f. Construction Cost Escalation

From the offtaker’s perspective, one of the key objectives in tendering out or negotiating a power project for development by the private sector is to establish price (and therefore tariff) certainty with respect to the capital cost of the project. The tariff will therefore be determined on the basis of a competitive bid or an agreed construction cost. The project company will in turn typically look to lock in the construction cost by negotiating a lump-sum, date-certain, turnkey contract with its EPC contractor. Thereafter, the basic principle is that the project company (under the PPA) and the EPC contractor (under the EPC Contract) will bear the risk of any cost-overruns. There are however, certain exceptions to this rule. Where the construction cost increases as a result of a variation required by the offtaker or changes in law (see

Chapter V.B.4.b (*Compliance with Law and Change in Law*) below), the PPA should allow either for direct compensation to be payable by the offtaker to cover the incremental cost in construction, or for the tariff to be adjusted to cover the incremental capital cost (and any associated financing cost).

g. Site Access and Availability

There are a number of potential risks and issues associated with construction that relate to the site selected for the project. These include geological risk (i.e., whether the site is geo-technically suitable for the construction activity), archaeological risk (the possibility of archaeological discoveries being made during excavation/construction and how such discoveries are managed), security risk (safety of personnel and materials at and in transit to the site), and any pre-existing environmental contamination that may be discovered during construction activities.

h. Right to Occupy

The project company's right to occupy the project site for the purposes of constructing and then operating the power plant is fundamental to the integrity and viability of the project. That right may take a variety of forms, ranging from outright ownership of the project site (potentially through acquisition from a third party), different forms of leasehold interest, concession arrangements, or other rights to occupy. These will vary based on the location and the circumstances of the particular project. The project company may also require additional access rights, easements, or written consents in order to carry out construction activities with respect to associated infrastructure for which it is responsible, such as transmission lines. Access to the project site will also be required, not only for the construction, operation, and maintenance of the power project, but also to afford the offtaker access to undertake whatever inspection rights it may have under the PPA.

In Iraq, the MoE and, for projects under the National Investment Law, the NIC generally will assist in obtaining these rights, as long as the project company holds a *musataha* right to the land.

i. Site Suitability

The project company will typically bear the primary responsibility for the suitability of the project site. Where the project company has had the opportunity to conduct full site surveys, including detailed soil sampling and geo-technical analysis, it may be reasonable for the project company/contractor to take responsibility for geological risk, particularly where the project company has been the primary driver for selection of the project site. Conversely, where the offtaker/government has effectively preselected the project site and/or the project company has had limited opportunity to conduct such reviews, it may be more appropriate for the offtaker to take such risk. This is particularly the case where the project site is effectively a brownfield site that is being made available to the project company. In such circumstances, the project company is likely to require appropriate protection, including time relief and deemed completion, as well as robust indemnities for third-party claims with respect to any preexisting environmental contamination.

j. Site-Related Infrastructure

It is generally the project company that determines and assumes the adequacy of road and rail links (or other transportation links) to and from the project site. This may also extend to the routing or rerouting of existing powerlines and water pipelines required for the supply of utilities to the project site. The availability of the supply of utilities to the project site is also typically the project company's responsibility, although this may vary where the offtaker, government authority, or other related party is operating an adjacent site and enters into an express contractual undertaking to supply such services. Similarly, where it is agreed that a significant piece of infrastructure (such as a transmission line, gas pipeline, or road) is to be undertaken by the offtaker or a government entity, the completion risk associated with such infrastructure may be assumed by the offtaker. Resettlement may also be required in order to acquire the project site. The impact on the timing of the project by a resettlement process should be carefully assessed by the contracting parties to the PPA.

k. Responsibility for Interconnection Infrastructure

The construction and operation of a new power plant need to be supported by a host of infrastructure. In addition to connection to the physical grid via transmission lines, which can vary from a few kilometers to hundreds of kilometers, the construction process also needs to be supported by the availability of utilities and access roads.

In terms of timing, the development of the power plant and associated transmission network needs to be coordinated to ensure that the power plant is ready to be connected to the grid at the time of commissioning. This also requires planning ahead in terms of availability of fuel and the infrastructure to bring in such fuel.

The project company and the offtaker must decide, typically at a very early stage, which party will be responsible (and bear the risk) for the construction of the transmission line, as well as the ongoing ownership and maintenance of the line.

l. Construction by Offtaker

Commercially, the prime incentive for the offtaker to take on the obligation to construct the transmission line is to avoid the higher construction cost if construction is undertaken by the project company. The increased cost of construction by the project company will be passed back to the offtaker through a higher tariff.

The advantage of potential cost savings of construction by the offtaker must be weighed against two disadvantages:

1. The offtaker may not have a source of sufficient funds to undertake the construction.
2. If the offtaker commits to constructing the transmission line, then the offtaker will also bear the responsibility if it fails to complete the transmission line when the power plant is ready for commissioning. Under the PPA, this will normally result in the offtaker being required to pay liquidated damages to the power plant, calculated as if electricity is deemed to have been delivered. To

reduce the risk of delay in implementing the construction, the offtaker will need to plan ahead in terms of financing and equipment procurement to ensure that completion can be aligned with the timing for completion of the power plant.

m. Construction by Project Company

Where the project company is responsible for constructing the transmission line, the offtaker will try to control the costs of constructing the transmission line since these costs will ultimately be passed back to the offtaker via tariff. The offtaker can try to control these costs by requiring all major supply contracts to be subjected to competitive tendering and by employing a competent engineer to oversee the implementation of the transmission line construction.

n. Delivery Point

Once the transmission line has been completed, the PPA identifies the obligation of the project company to deliver energy to a delivery point. The delivery point is a physical location that is specified in the PPA. The project company will want the delivery point as close to the power plant as possible. The offtaker will then take transmission line risk from and after the delivery point. However, this risk allocation may be specifically negotiated, particularly when the transmission line will be operated and maintained by a transmission company that is unrelated to the offtaker.

o. Testing and Commissioning

Testing and commissioning of the power plant is required before COD in order to ensure that the individual plant and equipment are functioning according to the design and the contracted performance output of the power plant. In addition to the testing of individual equipment, a complete power plant needs to be tested to determine the overall output parameters, including, among others, installed capacity, voltage output, frequency, and specific fuel consumption. The obligation to carry out tests and commissioning of the power plant rests on the project company, which has to ensure that experts and suitable test equipment are available when required before COD. Sufficient notice must be given to the offtaker and lenders, who may engage their own experts to witness the tests together with the project company's engineer.

Since part of the testing process for certifying the plant's capacity involves the generation of electricity, the offtaker must be prepared to receive that energy prior to the commencement of the testing and commissioning period. If the interconnector line or the network is not available, then pursuant to the terms in the PPA, the project company may claim liquidated damages for delayed COD, which may include evoking the deemed completion clauses in the PPA. Therefore, there is need for close coordination, especially where transmission lines are required, before and during commissioning of the power plant and related facilities. In case the offtaker's facilities are not available when testing and/or commissioning must begin, the project company may exercise the right to claim appropriate damages, including deemed capacity and energy output. The offtaker therefore should carefully evaluate its capacity to undertake its obligations to meet the requirements of the testing and commissioning of the power plant.

p. Failure to Meet Contract Capacity

Testing and commissioning may reveal lower-than-contracted outputs and/or failure to meet required performance levels, such as dependable capacity, specific fuel consumption (heat rate), and other issues. Depending on how much the test results differ from the specified output in the applicable contracts, there may be a need to rectify the plant to meet acceptable performance output. This may result in delays in achieving COD.

If there is no possibility for improving the performance of the power plant, then there are typically two options for the offtaker:

1. Accept the resulting output, with relevant penalties for not achieving the guaranteed output.
2. Reject the deal, and therefore terminate the PPA.

The PPA will contain relevant clauses to address the reduced performance output levels (usually addressed in the capacity charge payment of dispatchable generation plants). If the test results are not acceptable, then the PPA may have to be terminated or amended substantially, with other remedial actions taken to improve the performance to acceptable levels. The project company bears the risk of performance of the power plant throughout the term of the PPA.

q. Output/Heat Rate Risk Allocation

Upon testing, if the plant output and fuel consumption capacity fail to meet the contracted performance levels, the project company may have recourse through its EPC Contract to make claims against (i) the EPC contractor and (ii) the equipment manufacturer's warranties and guaranties. It is important to note, however, these protections are not directly available to the offtaker under the terms of the PPA because the offtaker is not a party to the EPC Contract or the equipment supply contracts.

2. OPERATIONAL PHASE RISKS

a. The Offtake Obligations

These payments are typically referred to as “availability payments” or “deemed energy payments” and are structured to ensure that the project company's capital costs (debt service, return of equity, and return on equity) and fixed operating costs are covered. In cases where the power plant is unavailable or incapable of generating electricity as a result of circumstances for which the offtaker (or government) has agreed to take the risk (including, among other things, political force majeure, force majeure affecting the offtaker, change in law, unavailability of the grid, and offtaker default), the project company may be entitled to deemed availability or deemed energy payments that are also intended to cover capital and fixed operating costs. These contractual devices are crucial to the allocation of risk in a power project.

b. Curtailment

Notwithstanding the basic principle described above, certain offtakers and/or the

relevant transmission system operator may want to reserve some flexibility with respect to the commitment to take interruptible energy through curtailment rights (i.e., the right to reduce the output from a power generator because of transmission congestion, lack of transmission access, low load periods, or other reasons). This will be a keenly negotiated issue. From the project company's (and the lenders') perspective, they will want certainty that the minimum offtake commitment will cover all fixed costs (including debt service and a minimum equity return). They may request that the PPA provide for an extended term if curtailment rights are exercised, or they may get comfortable with curtailment rights under the circumstances of the project.

c. Performance

The contracting parties will agree, when entering into the PPA, what the contracted capacity of the power plant will be. In order to reach COD, the power plant must be tested and certified as having met a percentage of the contracted capacity. This is generally referred to as a minimum capacity requirement. This testing typically involves participation by the project company, the offtaker and any independent engineer appointed by the parties. For power plants that are paid both a capacity charge and an energy charge, the tested capacity at COD may (depending on how the tariff is structured) determine the capacity charge the offtaker will pay to the project company. This testing is generally repeated on an annual basis, and in each instance the newly tested capacity will impact the capacity charge payable to the project.

If the power plant achieves or exceeds the minimum capacity requirement by the agreed date for the scheduled COD, but still does not achieve the contracted capacity, then the project company may have the option of either repairing or replacing the impacted portions of the power plant within an agreed period of time in order to achieve the full contracted capacity. At a certain point in time, the project company may be required to live with the capacity it has been able to demonstrate, and will no longer have the ability to increase the tested capacity up to the contracted capacity by fixing the deficiency and demonstrating the higher capacity of the power plant. In the event that the minimum capacity is not achieved by the agreed outside or longstop date for COD, the offtaker will typically have the right to terminate the PPA. Some PPAs may restrict the project company from delivering any energy in excess of the tested capacity locked in at COD, or may simply specify that the offtaker is not required to pay for such additional amounts.

In PPAs in which the tariff consists of both a capacity charge and an energy charge, because the offtaker is being required to pay for capacity of the plant, it will typically want to ensure that this capacity is available for its use. As such, an offtaker will typically impose minimum availability requirements. Availability is typically measured over an agreed period of time. Minimum availability thresholds are commonly negotiated by the parties and are uniquely dependent on project site conditions such as ambient conditions, the particular technical makeup of the power plant, and other efficiency criteria provided for in the PPA. The PPA would then provide a remedy to the offtaker for a failure by the project company to meet the minimum availability

thresholds. This may take the form of a right to terminate the PPA or the payment of performance liquidated damages by the project company. In any event, under a well-structured tariff, the offtaker should not be required to pay for capacity that is not made available to it.

d. Dispatch

Under the PPA, the project company is required to strictly comply with the dispatch instructions of the grid operator. The project company takes the risk of any operational failure to dispatch. The grid's dispatch protocol can be referenced by the PPA and becomes part of the PPA, or can be part of the transmission connection agreement to be signed between the project company and the transmission company. Dispatch plans are delivered to the project company to cater for monthly, weekly, and daily load planning purposes.

e. Special Considerations for Renewable Energy Projects

The allocation of performance risk in renewable energy projects is complicated by the generation profile for these projects, namely the fact that power generation is subject to the intermittent availability of the renewable resource.

In renewable energy PPAs, the offtaker only pays for the energy that is delivered. The obligation of the offtaker to pay at the tariff rate for delivered energy is sometimes capped at an amount set forth in the PPA, with any excess energy being remunerated at prevailing spot prices if there is a spot market. While the offtaker may insist upon a minimum capacity requirement, that threshold should be considerably lower than for dispatchable plants because of the inability of the project company to control the output of its renewable energy project.

Put simply, renewable energy projects are in many ways subject to the whims of the sun, the rain, and the wind, and are unable to guarantee a particular capacity on any particular day.

Similarly, while the offtaker would prefer to set a minimum availability requirement in order to support its projected net power capacity, shifting this risk to the project company may severely deter investment in renewable energy projects. A compromise solution is to establish minimum availability requirements that are substantially lower than dispatchable power plants in order to allow the project company flexibility to weather unforeseen environmental variables while still leaving the offtaker with the confidence that the project could be terminated if the lower availability requirement is not met for an extended period of time.

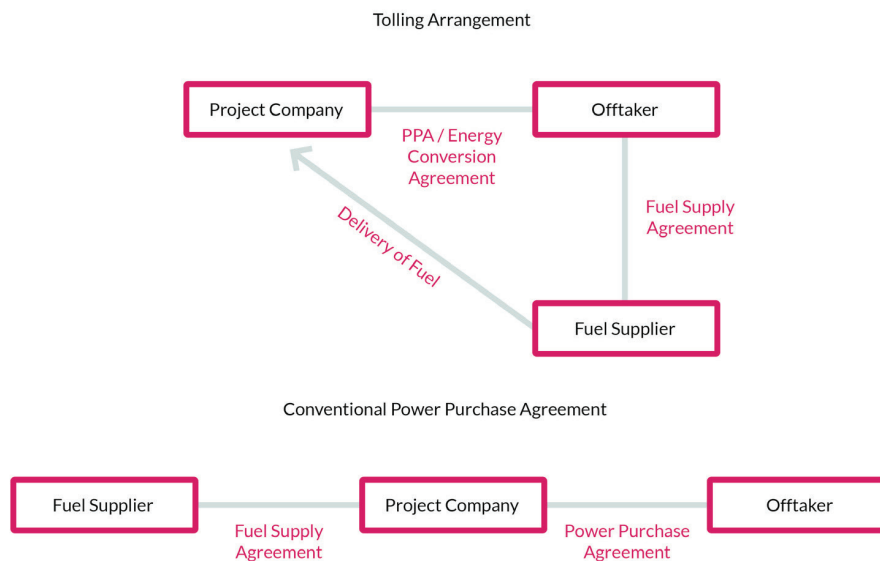
f. Fuel and Other Feedstock Supply

The long-term adequacy of supplies and the pricing for fuels and other supplies of feedstock is one of the most critical elements in a power project. The allocation of fuel supply risk will depend on a number of issues including, in particular, which party is in the best position to negotiate the supply, the financial viability of the fuel supplier, the availability/accessibility of alternative fuel suppliers, and the state of development of the relevant market for fuel supply.

(i). Tolling Arrangements

Project companies are not always in the best position to negotiate and secure a stable supply of a fuel resources such as oil, coal, natural gas, biomass, or steam. The offtaker or government may be better positioned to do so. In such circumstances, the offtaker may prefer to structure the power project as a tolling arrangement. This may make sense, particularly when the fuel supplier is owned by the government or affiliated with the offtaker.

Under a tolling arrangement, the offtaker takes full responsibility for the procurement (including payment) and supply of fuel to the power plant. If the offtaker wishes to dispatch the power plant, it needs to ensure that a sufficient volume of fuel is delivered to the power plant to allow the electricity it dispatches to be generated. The project company will then take responsibility for ensuring that the fuel delivered to the power plant is utilized in an efficient manner. This is accomplished by requiring the project company to convert fuel into energy at an energy conversion rate that reflects the agreed efficiency of the power plant given the ambient atmospheric and transmission conditions. In Iraq, tolling fees cannot be imposed on electricity without the passage of a specific law. There are also legal and cultural impediments to fee collection. Offtakers are deemed as investors under the National Investment Law. Any assignment of contract rights to offtakers must have clear written approval from the MoE. The NIC allows for assignment of contract rights upon completion of 40% of the project and written approval the MoE.



Under a tolling arrangement, therefore, the offtaker or the host government will enter into fuel supply agreements directly with third-party fuel suppliers and be responsible for the fuel resource payment. Then the offtaker will enter into a separate agreement, which may be called a PPA, a tolling agreement, or an energy conversion agreement, with the project company. This will contain both the conventional PPA terms and certain terms for the fuel supply. For ease of administration, the project

company may give instructions directly to the third-party fuel supplier for the delivery of fuel, and agree to protocols for nominating quantities of fuel to be delivered and for taking deliveries of that fuel, but the project company should not bear responsibility for payment nor the risk that the fuel supplier may breach its obligation to deliver the fuel properly nominated by the project company.

(ii). Fuel Supply Agreements

Offtakers will often seek to pass greater responsibility onto the project company for procuring fuel supply and require the project company to enter into a fuel supply agreement with a third-party fuel supplier. The project company will then need to contract for sufficient volumes of fuel to meet its contractual commitment to make the power plant “available” under the PPA, so that, if the offtaker elects to dispatch the plant, the project company has sufficient fuel to generate. Conversely, it is important that the project company does not contract for quantities of fuel that it cannot use, or the project company will be making unnecessary payments for excess fuel that cannot be used to generate power.

A detailed analysis of fuel supply agreements is beyond the scope of this Legal Guide, but the project company will need to ensure that a number of key issues are covered, including:

- A binding legal obligation on the part of the fuel supplier to provide the contracted quantity of fuel. This can be contrasted with a “best endeavors” or “best efforts” type of obligation, which creates the risk of fuel supply failure with little or no remedies for the plant developer;
- Appropriate levels of flexibility with respect to monthly and annual contracted quantities to address circumstances in which the power plant is not dispatched;
- Appropriate protections with respect to the supply of off-specification fuel. The fuel must meet certain specifications. The offtaker should be entitled to receive liquidated damages from the fuel supplier to cover additional costs incurred as a result of burning off-specification fuel (including the increased use of filters and stoppage time for cleanups and startups);
- To the extent that the project company is assuming responsibility for fuel supply under the terms of the PPA, the project company will also need to ensure that any liability it incurs under the terms of the PPA for non-availability due to fuel supply failures is passed through to the fuel supplier. It is often difficult or impractical to obtain agreement from a fuel supplier to bear such liabilities; and
- Alignment of the commencement of the fuel supply with the commissioning and testing of the power plant under the PPA to ensure the availability of fuel to test the plant before the scheduled COD provided for in the PPA. However, the fuel supply start date should not be too early, or the project company may end up paying capacity payments under the fuel supply agreement well before the fuel is actually needed.

In addition, liabilities that the project company incurs under a fuel supply agreement in respect of a take-or-pay obligation will, where appropriate, need to be passed through to the offtaker under the PPA. In other words, to the extent that the project company is liable to pay for fuel that is not taken due to a risk assumed by the offtaker under the PPA, the offtaker will need to indemnify the project company for this liability.

As a result, a number of the provisions of the fuel supply agreement will be of direct interest to the offtaker. The fuel price will usually be a direct pass-through under the PPA (assuming that the fuel is converted into energy at the agreed efficiency). It is therefore important for the offtaker, as part of project due diligence, to review and ensure that the fuel cost is reasonable and consistent with industry rates. The offtaker should also review the minimum take-or-pay commitment for fuel in the fuel supply contract. Given that the contractual commitment for plant availability is always lower than 100%, factoring in periods of maintenance, it is important that the minimum take-or-pay commitment for fuel is not so high as to create a payment obligation for fuel for periods when the fuel is not being utilized due to planned maintenance. In the same vein, the project company should aim to align the scheduled maintenance of the power plant with the scheduled maintenance of the gas facilities (in the case of a gas-fired power project) as a misalignment may lead to the plant being unable to produce power due to ongoing maintenance of the fuel facilities.

It is also important to note that the existence of a separate fuel supply agreement between the offtaker and the fuel supplier does not necessarily mean that the offtaker must take full fuel supply risk under the terms of the PPA. The offtaker's ability to accept fuel supply risk under the PPA will depend largely on its recourse to the fuel supplier and/or its access to readily available alternative sources of fuel. If the fuel supplier is the only or primary viable source of fuel supply, the offtaker will need to ensure that, upon a fuel supply failure, it has recourse to the fuel supplier on a full indemnity basis for any shortfall in revenue, any penalties payable under the terms of the PPA, and ultimately the loss suffered on termination of the PPA. The offtaker will also need to consider the credit status of the fuel supplier. Will the fuel supplier have the financial resource to pay out on such an indemnity? If not, what sort of credit enhancement is available in the form of liquidity support and/or guarantees (including, if necessary, sovereign guarantees)?

(iii). Fuel Transportation Arrangements

These considerations may involve further complexity if there is a division of responsibility for supply and transportation of fuel. Depending on the proximity of the plant to the fuel source and the nature of the fuel, it may be necessary to enter into a separate agreement with a transporter for transporting the fuel from the fuel processing facility to the plant. This would likely increase the risk elements of the project, as the fuel supplier could transfer title and risk of the fuel to the fuel transporter or the project company at a delivery point that is still far from the plant.

Where the fuel supplier commits to delivering the fuel to the delivery point at the

power plant, the fuel supplier will bear the risks associated with ensuring that fuel of the right quantity and specification reaches the delivery point at the plant. Where, however, there is a separate contract for transportation of the fuel, that contract would apportion risks among the fuel supplier, the transporter, and the project company. The delivery of off-specification fuel to the plant, for instance, may not be the fault of the fuel transporter, but may result from off-specification fuel being provided to the fuel transporter by the fuel supplier, in which case the project company should have recourse to the latter through the remedies provision of the fuel supply agreement. If the fuel transporter is publicly owned, the project company may make an argument for the offtaker to bear the risk of nonperformance or defective performance by the fuel transporter, in addition to fuel transportation force majeure. However, depending on how well capitalized the public fuel transporter is, it may be able to bear such risks on its own, which also avoids the political challenges of one government entity (the offtaker) bearing the risks of another government entity (the fuel transporter).

g. Transmission

In a bundled system like Iraq, the market roles of power purchasing, transmission, and distribution are all bundled into one entity: the offtaker. The offtaker, the MoE in Iraq, usually bears responsibility (and the risk) for transmitting the power that is produced and sold by the project company. Similarly, the offtaker in this system will have the obligation to keep the power plant connected with the power grid.

h. Foreign Exchange Rate Fluctuation

Ideally, financing for the project should be obtained locally and in the host country's currency to avoid exchange rate risks. However, this is rarely possible in emerging markets where there is an underdeveloped banking industry and limited capacity for lending. When financing for the project cannot be obtained in the local currency of the host country, and the tariff cannot, for whatever reason, be denominated in the foreign currency in which the investment was made and the financing is obtained, the project company will need to seek funding in an alternative currency and protect itself against short-term fluctuations (but not catastrophic devaluation) in exchange rates.

Mitigation of short-term exchange rate risks is commonly achieved through one or more of the following means:

1. All tariff components are denominated in the funding currency and the offtaker is required to pay electricity fees in the local currency equivalent to the electricity fee denominated in the funding currency;
2. Entering into derivatives and future currency swap arrangements with credit-worthy counterparts; and/or
3. Government undertaking to make up losses due to exchange rate fluctuations (a less common approach).

While each of the above is effective in mitigating against short-term currency exchange fluctuations, neither is capable of protecting the project company against

catastrophic devaluation risk. In the event of a catastrophic devaluation of the host country's currency, it is unlikely that the end-users or the host government will be able to afford the increase in tariff or shortfall payments for an extended period of time. Mitigation of the risk of a catastrophic devaluation is usually best achieved through insurance in the form of a currency hedge.

i. Convertibility and Remittance

In locations where the local currency is not freely convertible and foreign currency is required to make debt payments and distributions, the project company could face difficulties in securing access to foreign currency in which the investment was made and debt is being serviced. While the host government would normally provide an undertaking to ensure the convertibility of currency throughout the term of the project, convertibility and remittance risks remain on two fronts:

- Breach by host government of its undertaking on convertibility; and
- Lack of foreign currency reserves to meet its conversion obligations.

Mitigation against such risks can be achieved in a number of ways:

1. Build up an offshore debt service reserve account that should help to create a buffer for short-term conversion obstacles;
2. Swap for other valuable commodities in lieu of cash payment; and
3. Obtain political risk insurance cover on currency inconvertibility.

In Iraq, there are no currency or foreign exchange restrictions on revenues generated by the project company if the project is licensed by NIC. There are no special rules in Iraq regarding the transfer of money in relation to power projects. It is advisable, however, to refer to any existing international treaties between Iraq and other countries that might impose special currency exchange conditions. Parties are generally free to transfer investment capital outside of Iraq, along with debts, revenues, and amounts payable, in foreign currency. Additionally, parties freely apply such amounts as contributions to the capital of any other company in accordance with the instructions of the Central Bank of Iraq.¹³⁶

3. PAYMENT RISKS

Although the components of the revenue stream (capacity and energy) are contractually agreed under the PPA, there still exists the risk that the offtaker does not meet its ongoing payments to the project company when required. This is known as payment risk. Non-payment by the offtaker will impact the ability of the project company to meet its scheduled payment obligations, which include capital costs, fixed operating costs, and debt service. This risk is magnified when the offtaker is seen as not creditworthy and/or financially insolvent.

Furthermore, the termination provisions in the PPA will typically stipulate a termination amount to be paid by the offtaker to the project company in exchange for

¹³⁶ For further information on this topic, refer to the Central Bank of Iraq Law of 2004.

transfer of the power plant ownership to the offtaker. The termination amount payable is usually large and, as with payment risk, funders are concerned as to whether the offtaker will be able to fund the termination obligation in the event of a termination of the PPA.

The project company can seek to mitigate this risk with respect to a government offtaker by obtaining a sovereign guarantee or political risk insurance, or, in the case of a non-government offtaker, a parent guaranty or other credit support.

4. POLITICAL AND OTHER RISKS

Political risk represents the probability of disruption of the operations of private sector businesses by political forces, actions, or events, whether they occur in the host country or result from changes in the international environment.

Political risks are typically those which the host government is considered better placed to manage. This management will often embody a wide range of risks, including:

- Restrictions on the convertibility of local currency into foreign exchange and its transfer outside of the host government;
- Expropriation of ownership, control, or rights to an investment;
- Breach of contract by the host government of a contractual obligation (such as construction of a transmission line);
- Terrorism and acts of violence;
- War, civil disturbances, and insurrection;
- Changes in law, including taxation and other adverse legal or regulatory changes;
- Refusal of government agencies to grant permits and approvals after the developer has fulfilled all necessary requirements; and
- Action or inaction by the host government or government authorities.

Such risks will often be captured in a PPA through the concept of Political Force Majeure or Political Risk Events. Some of these risks are explained in further detail below.

a. Sovereign Risk and Expropriation

A PPA is a commercial agreement for the supply and purchase of electricity between a private developer and an entity frequently owned by the government. There is a risk that the government may decide to interfere in the functioning of the plant, directly or indirectly, with the result that the project company is no longer able to generate project revenues. In turn, this will jeopardize the project company's ability to service its debt, as well as shareholders' return on equity. Such interference is typically provided for either under local political force majeure or a separate provision dealing with government risk events.

The consequences of expropriation should be addressed in the PPA. Expropriation may be in relation to the physical plant or shares in the project company, and the PPA should cover both instances. In the former case, the government could deploy security personnel to physically take over the plant, and in the latter case the government could compulsorily take over ownership of shares in the plant. There is need for clear definition of actions that come under this umbrella, including nationalization, confiscation, requisition, and other related actions.

It may also be necessary to make provisions for creeping expropriation, which usually refers to situations in which the government does not directly expropriate a plant but takes measures that ultimately ensure that the project company is no longer in effective control of the plant, including onerous regulatory impositions and restrictions in foreign currency purchase or repatriation where the PPA tariff is denominated in local currency. Such measures may be covered in provisions dealing with local political force majeure or change of law or tax which, unless compensated for by the offtaker, could spell doom for the project.

It is also important for the PPA to provide for what is not expropriation. Otherwise, the government may find itself facing severe penalties for taking legitimate actions that are not generally recognized as amounting to expropriation. Governments are usually able to take measures for regulating economic activity in the country, including health and environmental safety measures and tax-related measures. However, such measures must be made in good faith and not be discriminatory in nature or primarily intended to confiscate private property. Also, when a project company has contractual agreements with government-owned companies responsible for associated infrastructure, such as transmission and gas transportation, it is also important to distinguish between expropriation, which is essentially a political act, and commercial disputes, which should be dealt with in accordance with the remedies provided for in these agreements.

Developers typically argue that expropriation should be treated as a termination event under the PPA, for which the project company should be fully compensated for the expected revenue stream over the life of the PPA. In any case, compensation under PPA termination may or may not be appropriate, depending upon the extent to which the offtaker is independent from the government. The more independent the offtaker is, the better the argument that the project company and the lenders should cover the risk of expropriation in some other way, rather than expect the offtaker to pay them in full for such event.

In addition, all parties should consider whether the offtaker will have a source of funds to make any termination payments in the event of expropriation. Ideally, this obligation would be supported by a sovereign guarantee, but that may be difficult to obtain.

Where there is a separate agreement dealing with the compensation regime, such as a Put and Call Option Agreement, it should clearly provide for exactly what the payout should be in the event of expropriation to avoid any ambiguity.

A developer may also consider getting political risk insurance from an institution like MIGA. The benefit of MIGA insurance is not just the certainty of a payout in the event of expropriation, but more importantly, the reduced likelihood of expropriation due to the reputational risk for the government and the likely adverse collateral impact on its perception in other international transactions.

b. Compliance with Law and Change in Law

The offtaker and the government will likely require the project company to contractually commit in the PPA to comply in all material respects with the laws of Iraq. The project company should in turn be able to commit to do so, at least by reference to applicable laws at the outset of the project on the basis of legal due diligence and advice. The project company (and by extension its lenders) will, however, find it difficult to give an unqualified commitment to comply with laws to the extent that laws may change over time.

The concept of “Change in Law” has evolved to include (i) the introduction of new law, (ii) modification of existing law, and/or (iii) changes in the interpretation of law by any court, tribunal, governmental entity, or other authority that has applicable jurisdiction or regulatory oversight with respect to the project or the project company. “Law” in this context should be defined to cover a comprehensive range of legislative, statutory, and regulatory instruments, orders, guidelines, etc.

There may be some debate between the offtaker and the project company as to the date from which any Change in Law should be considered. This will often be the date of signature of the PPA. However, where the project company has committed to a tariff in the course of a tender process, it may be more appropriate to set the date at the date of submission of the project company’s proposal (in response to the RfP). This is an issue that can sometimes be resolved by due diligence to determine whether a Change in Law has occurred that might have an impact on the project company’s cost structure. However, depending on the transparency of legislation in the location and the time available to the project company to perform such due diligence, it may make more sense for the offtaker to add this incremental risk to the risk of changes in law after execution of the PPA, which it will often already have agreed to take.

A Change in Law may impact the project company in a number of ways:

1. It may adversely affect performance of a particular obligation under the PPA or render performance impossible;
2. It may adversely affect the project company’s revenue stream;
3. It may require the project company to incur a one-off capital cost or cause an ongoing increase in the project company’s operating costs (in each case, in order for the project company to comply with the relevant change in law); or
4. Conversely, it may lead to a reduction in the project company’s operating or forecast capital expenditure.

Subject to appropriate materiality thresholds, the project company and offtaker will generally agree that the project company should be left in no better or worse position than if the relevant Change in Law had not occurred. Thus, to the extent the project company is temporarily unable to perform an obligation as a result of a Change in Law, this will not constitute a project company default and any time limits imposed on the project company will be extended accordingly. Furthermore, to the extent that the Change in Law causes a delay in COD, the plant may be “deemed complete” and to the extent that the plant is unavailable as a result of such Change in Law, the project company may be entitled to Deemed Availability or Deemed Generated Energy payments. In addition, to the extent that the project company incurs an increase in costs or decrease in revenues as a result of a Change in Law, this will entitle the project company to receive either (i) direct compensation to pay for or reimburse the project company for such cost or revenue shortfall, or (ii) an appropriate tariff increase. Conversely, if the project company benefits from a Change in Law, then an appropriate downward adjustment in the tariff will typically apply.

To the extent that a Change in Law renders performance under the PPA impossible, the project company will generally be entitled to terminate the PPA with the level of compensation applicable assessed in the same way as termination for Political Force Majeure.

5. CONSENTS, PERMITS, AND LICENSES; LAPSE OF CONSENT

a. Project Company’s Responsibility to Secure Consents, Permits, and Licenses

Offtakers understandably want power plants to be built and operated in accordance with the consents required by the applicable law. To ensure this occurs, parties to the PPA will want to clearly delineate who is responsible for obtaining the various permits.

The project company is typically responsible for obtaining the necessary consents to build, own, and operate the power plant. These include, among others: a construction permit, an environmental license, an archaeological permit, and an operating permit. The term consents are generally understood to include any registration, declaration, filing, consent, license, right, approval, authorization, or permit.

For a project under the National Investment Law, the NIC can assist with identifying and obtaining all necessary consents and permits (see also Chapter II (*Iraq Power Sector’s Finance & Legal Landscape*) of this Legal Guide).

b. Offtaker’s Obligation to Assist in Securing Consents, Permits, and Licenses

It is not the case that all obligations regarding consents reside with the project company. Because the offtaker is often affiliated with the government, it is anticipated that the government will have some connections to, and influence over, other government agencies. In addition, as an established entity in the domestic market, the offtaker is often more familiar with the legal and regulatory requirements for operations in the market. As a result, the parties will typically agree that the offtaker should be obligated to offer “reasonable

assistance” to the project company in obtaining consents. Ultimately, this is in the interest of all of the parties, including the lender, who will need the assurance that the project company has obtained all of the necessary consents.

c. Joint Coordination for High-Level Approvals

In certain instances, the parties may agree that the responsibility to obtain particular consents from higher levels of government is a joint responsibility. Such approvals might include consents of the relevant authorities (such as cabinets, parliaments, ministries of finance, ministries of energy, tax authorities, regulators, and central banks). Since such consents are often necessary for the effectiveness of a PPA, it generally makes sense that both parties would work together to ensure that they are obtained on time.

d. Lapse of Consent

Where a government authority fails to grant or renew a consent upon due application of the project company, this will be treated in the same way as a Change in Law. This is sometimes referred to as a Lapse of Consent. Note that where the project company is unable to complete the requisite formalities to obtain or renew a consent as a result of a Change in Law, the Change in Law protection should nonetheless apply. It bears noting that the concept of Lapse of Consent is sometimes referred to in PPAs as a political force majeure event, with the same net effect.

6. TAX ISSUES

a. Change in Tax

Changes in tax may severely impact project revenue and could result in making a project fundamentally uneconomical. The change may come in the form of a change in tax rate, the creation of a new class of tax, or removal of relevant tax benefits that may adversely affect the project’s return on investment and/or its ability to service its debt. The consequences of a change in tax may:

1. Increase or decrease project costs;
2. Increase or decrease the maintenance and operation costs; and
3. Increase or decrease the revenues expected by the project company.

Material issues to consider in relation to the management of change in tax risks include the reference date by which the change in tax is measured and whether the change is discriminatory in nature.

b. Reference Date by Which Change in Tax is Measured

A change in the tax position must be defined relative to the tax position at a reference date. The reference date is commonly agreed between the parties and could be the date of the signing of the PPA or the date of financial closing.

c. Whether the Change is Discriminatory in Nature

In determining which party shall bear the risk of change in tax, distinction is normally drawn between three categories of changes:

1. Changes that are applicable specifically to the project and the involved sponsors, contractors, and lenders only (a Discriminatory Change in Tax);
2. Changes that are applicable to the industry in general or a similar class of investors (a Specific Change in Tax); or
3. Changes that do not fall into the above two categories and are applicable to the general community (a Non-discriminatory Change in Tax).

For a Discriminatory Change in Tax, the oftaker is normally expected to bear this risk by means of tariff pass-through. In other words, any increased tax charges are included in the tariff calculation of project costs, and therefore the oftaker has to pay a tariff that is reflective of the extra tax charges. For a Non-discriminatory Change in Tax, the project company is normally expected to accept this as part of the risk of conducting business in the host country. For a Specific Change in Tax that is not discriminatory in nature, the parties may negotiate risk.

d. Mitigating the Risk of a Change in Tax

Mitigation measures against changes in tax are normally implemented through one or more of the following:

- **Host government undertaking and political risk insurance:** An undertaking by competent government authority(ies) of the host country that no change in tax, imposition of new tax, or removal of tax benefits will be applicable to the project company, its sponsors, and contractors throughout the life of the project. The project company can further mitigate this risk by obtaining political risk insurance to insure against breach of the undertaking by the host government.
- **Tariff Pass-Through:** The tariff is designed to allow full pass-through of any increase in tax, imposition of new class of tax, or removal of tax benefits during the term of the Project that are “discriminatory” or “specific” in nature.

For projects in Iraq without an investment license, there is no way to mitigate a change in tax. Projects under the National Investment Law are legally protected against changes in tax, even after the expiration of an initial 10-year tax exemption period.

7. CHANGE IN CONTROL

Just as important as assessing the viability of a project, both the lenders and the oftaker must undertake an assessment of the project company itself and the parties in control of the project company. The reputation of these parties, their experience, and their track record all influence the oftaker and lenders in assessing whether the project company will have the ability to meet its obligations under the PPA. It therefore becomes important to both the oftaker and the lenders that the project company’s shareholders be restricted from unilaterally changing the control of the project company.

PPAs normally contain explicit provisions on the meaning of control and what constitutes a change in control of the project company. The PPA could provide that a change in control of the project company cannot occur without oftaker consent.

Typically, the PPA will state that the offtaker cannot unreasonably withhold its consent. Alternatively, a change in control may only be allowed after a prescribed time period (this may be aimed at, for example, locking in the parties for the initial loan term, or for the construction phase). Further conditions may be imposed that if a change in control has to occur, then it cannot reduce the local content requirement of the project company, or that the new entities must have the same reputational standing as their respective predecessors. The latter may be quite a subjective assessment. The restrictions and conditions will vary from project to project.

The project company may also have an interest in changes in control of the offtaker, particularly in those locations undergoing an unbundling of the electricity supply industry and the restructuring of a monopoly utility offtaker. Where sovereign support has been provided for the offtaker's obligations under the PPA, this issue may be less important to the project company. However, where no such support has been provided and the investment grading, reputation, and sophistication of the offtaker were key considerations for the project company and the lenders when concluding the PPA, then the offtaker may be similarly restricted from undergoing a change in control without the project company's consent. There may also be conditions imposed on the offtaker, such as the restructured offtaker having the same investment grading as its predecessor or an obligation that sovereign support be provided.

8. FORCE MAJEURE

It is important to have a clear provision dealing with force majeure in a PPA, which will set out the meaning and consequences of force majeure and who bears those consequences. These provisions may also specifically describe what is not covered within the scope of force majeure in the PPA.

a. Key Features of Force Majeure

In general, force majeure tends to have the following defining features (see also *Legal Guide to Investment in Iraq*):

- The event has material adverse impact on a party's ability to discharge contractual obligations.
- The event is not the fault of the party seeking relief and is beyond the reasonable control of the party.
- The event could not have been reasonably foreseen by the party, and reasonable measures could not have been implemented by a diligent party to avoid it or mitigate its impact.

Sometimes, the definition extends beyond the event itself to the continuing impact of the event. For instance, when there is a major unexpected flood that damages a power plant, and it takes up to a month for the flood water to be drained out before the commencement of damage assessment, the force majeure relief claimed could go beyond the day of initial flooding and also extend to the continuing impact of the flooding.

It is also important to clarify what is not covered within the scope of force majeure. Where a power plant is down because of poor maintenance, it would not fall within the scope of force majeure. This would also be the case when the project company has failed to contract for a sufficient quantity of fuel to enable it to produce the full contract capacity.

b. Types of Force Majeure

Force majeure events under a PPA can be placed in a number of categories, including the following:

Local Political Force Majeure tends to cover events that are either caused by the government of the host country or could be best prevented, controlled, or mitigated by the government. Events in this category would include widespread riots and civil disorder, acts of terrorism, and nationwide industrial strikes. The scope could also extend to lack of transmission grid availability to transmit power from a power plant owned by the government, as well as lack of any other associated infrastructure needed by the power plant that is publicly owned or controlled. Some elements of change in law could also fall within the scope of local political force majeure, such as the host government's introduction of restrictions on capital repatriation, which prevents scheduled payments to offshore equity and debt providers.

Foreign Political Force Majeure tends to cover acts of a political nature that are of foreign origin but still have a material adverse impact on a party's ability to continue with PPA obligations. For instance, an industrial strike in a foreign country could mean that a critical piece of plant equipment, such as a replacement turbine manufactured in that country, cannot be exported to the country where the power plant is located. A trade embargo could also have a similar impact.

Natural Force Majeure covers events such as flooding, hurricanes, earthquakes, tsunamis, and other adverse weather or natural conditions that have a material adverse impact on a party's ability to meet its contractual obligations.

c. Extension of Force Majeure

Typically, a PPA will provide for force majeure relief to extend beyond the PPA to other project agreements that the PPA parties are also party to, including the fuel supply and transportation agreements, the EPC contracts, and the transmission agreements. As such, where the occurrence of a force majeure event prevents the fuel supplier or transporter from supplying fuel to the power plant, the project company may be able to seek relief from its contractual obligation under the PPA for minimum plant availability. Given the fact that a PPA counterparty may wish to seek force majeure relief for events that occur under other agreements, it is important to aim to harmonize force majeure across all of the project agreements. Otherwise, there is a risk that an event that is defined as a force majeure in the transmission agreement, for instance, may not be featured as a force majeure event under the PPA.

Consequently, on account of the misalignment, that event may not qualify a party for relief from its other contractual obligations.

d. Relief from Contractual Obligations as a Result of Force Majeure

As has been discussed, a party claiming force majeure usually wants relief from contractual obligations during the duration of the force majeure event. If the force majeure period is protracted, the PPA will usually identify how long relief from contract obligations will be granted before the unaffected party can seek contractual termination.

In a PPA, it is often important to draw a distinction between force majeure affecting the offtaker and the project company, respectively. When the offtaker is affected by force majeure, the PPA will usually provide for continuation of capacity and energy payments to the project company during the period of the force majeure. If the effect of the force majeure event affecting the offtaker is to delay COD, the project company may be entitled to claim a deemed completion. In that instance, the project company may be entitled to deemed capacity payments that cover debt service (which will commence on the original COD) and any additional project costs incurred as a result of the delay.

When the force majeure affects the project company, the impact on capacity or energy payments may depend on the specific type of force majeure. Such payments will typically continue in the case of Local Political Force Majeure, but could be suspended in the case of Natural Force Majeure or Foreign Political Force Majeure. Also, a project company affected by force majeure may still be able to produce some power even if it is below the contract quantity, and provision should be made in the PPA for such power to be purchased and paid for nonetheless.

e. Specific Remedies as a Result of Force Majeure

Although the primary form of relief in the case of force majeure may be the suspension of certain contractual obligations, there are also other forms of specific remedies for force majeure that may be provided for in the PPA. One common example is an extension of certain time periods under the contract in order to account for the delay caused by the disruptive event. If the force majeure delay occurs during the construction phase, the project company should be entitled to an extension of the time period for achieving COD. If the force majeure delay occurs after COD, the full term of the contract should be extended to account for the delay. Other project agreements should be aligned accordingly.

f. Force Majeure under Iraqi Law

Articles 168 and 425 of Iraq's Civil Code allow for a party to a contract to be excused from performance if nonperformance or a delay in performance is due to a cause beyond that party's control. It is unclear whether Iraqi law gives rise to compensation in such cases.

Below are examples of typical force majeure provisions from a standard investment agreement:

“If either Party is unable to meet its obligations due to Force Majeure, such Party shall be excused from meeting its obligations during that period in accordance with this contract and shall not be obliged to pay any fees or compensation resulting from such Force Majeure.”

“If a Party is unable to perform its obligations in whole or part due to Force Majeure, or if such Party knows of its inability to meet its obligations because of that, such Party shall notify the other Party in writing as soon as possible, provided that such notification shall not exceed [180] days after actual knowledge of the occurrence or the possible occurrence of Force Majeure.”

For additional force majeure standard provisions, please refer to the *Legal Guide to Investment in Iraq*.

CHAPTER VI. CONCLUSION

Despite abundant fossil fuel reserves and a location ideal for solar generation, Iraq currently suffers from a significant deficiency in power generation, with demand far outstripping supply. This deficiency creates political instability both directly, as a result of citizens dissatisfied with rolling blackouts, and indirectly, due to a lack of economic growth and job creation. Given low oil prices and the need to fund security operations, the government of Iraq simply does not have the ability to self-fund the necessary power generation needed for its population. As described in this Legal Guide, the government of Iraq has put forth a concerted and comprehensive effort to provide significant incentives to investors in the power sector. This includes land rights and infrastructure, NIC support in obtaining permits and licenses, investor-favorable tariffs, taxes, and customs incentives, and MoF guarantees for eligible projects.

While investing in Iraq is certainly not without its challenges, it is the sincere belief of the authors that such an investment can benefit the investor, Iraq, and the region as a whole. Investors willing to take the risk will benefit from government incentives that may not be available in the future, as well as gain an early foothold in what has the potential to be a strong regional market. For Iraq, reliable power generation will allow it to improve its economic outlook by developing a broad set of industries and maximizing its educated workforce to help the country diversify from oil. Perhaps more importantly, such development in power generation will undoubtedly reduce political and social instability by decreasing unemployment and providing Iraqi citizens with their seemingly inalienable right to power, especially for medical, educational, and basic living purposes. Given its location and both its cultural and significant historical relevance in the Middle East, a stable and prosperous Iraq would be a tremendous benefit to the region and the world.

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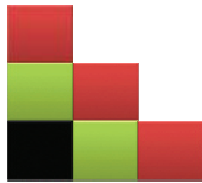


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