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Client Alert: The New Legal Framework for Sovereign Debt in the Kurdistan Region of Iraq

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Introduction

The recent USD 34.8 million UK Export Finance (UKEF) deal with the Kurdistan Regional Government ("**KRG**") for the financing of the UK supplier Biwater's "scoping phase" for water and waste water treatment solutions for the cities of Erbil and Sulaymaniyah in Kurdistan, Iraq, has again underlined the importance of the Kurdistan Debt Law. The UKEF financing was completed in December 2016. (The UKEF press release is available here.)

Lawyers from multiple offices of Amereller advised UKEF on all aspects of Iraqi law in relation to the transaction, which was the first of its kind under the new Kurdistan Debt Law.

J.P. Morgan acted as mandated lead arranger.

Kurdistan Debt Law

Prior to 2015, there were serious concerns about whether the KRG could borrow in the capital markets or, indeed, under bilateral loan arrangements. However, the position was clarified when the Kurdistan Debt Law was enacted in 2015. The law provided a much-needed legal framework for sovereign borrowing. Among the key features of the law are the following:

- The KRG is authorized to enter into sovereign borrowing transactions (including guarantees) up to an aggregate amount of USD 5 billion.
- Transactions can be denominated in foreign currencies.
- Under the aegis of the Council of Ministers a "special committee" is established to negotiate and sign sovereign debt transactions under a general framework determined by resolution of the Council.
- Transactions are not subject to the 7% interest rate cap under the Iraqi Civil Code.
- Transactions are exempt from stamp duty and withholding tax in the Kurdistan Region.
- Disputes arising from transactions can be settled through arbitration.

The Kurdistan Region as an "autonomous region"

The Kurdistan Region is a region of the Republic of Iraq that enjoys a high level of autonomy, but has depended on financial support from the Federal Government of the Republic of Iraq. Recent political differences with Baghdad, combined with an increasingly vocal KRG leadership, have brought the constitutional position and the question of the region's financial independence into sharper focus.

Constitutional Controversies

One of a number of controversial issues under the Kurdistan Debt Law is whether the KRG requires authorization from the Iraqi federal government in order to enter into sovereign debt transactions.

This discussion revolves around the interpretation of the Iraqi Constitution and the Federal Debt Law, which governs the public finances of the Republic of Iraq, and which was issued as CPA Order 95 by the Coalition Provisional Authority during its time as the transitional government established following the fall of the regime of Saddam Hussein.

According to Article 110 (1) of the Iraqi Constitution, the Federal Government has the exclusive authority "to negotiate, sign and ratify debt policies." Moreover, Section 10 (2) of the Federal Debt Law provides that the regions may only enter into borrowing or guaranteeing transactions with the Federal Government's consent. In the past, this has been understood by some lawyers to mean that the KRG cannot incur debt independently from the Federal Government. This is a position often asserted by persons within the Federal Government.

The aforementioned, Article 110 (1), in common with many other provisions of the Iraqi Constitution, is poorly drafted. However, in aggregate the better arguments speak in favor of Kurdish financial independence:

- According to Article 110, only debt "policies" are a federal matter. This suggests that specific debt transactions are not caught within federal jurisdiction and are subject to the general allocation of competencies to the regional governments of Iraq. The KRG should therefore have the full autonomy to regulate debt as is done by the Kurdistan Debt Law. This interpretation is consistent with the decisions the Iraqi supreme court in the field of taxation, where general policies are determined by the Federal Government, while the regions and governorates may levy specific taxes.

- The Federal Debt Law was not formally enacted as law in the Kurdistan Region. As a general rule, since the establishment of the KRG, all laws issued by the Republic of Iraq are applied only in the Kurdistan Region after they have been endorsed by the Kurdistan Regional Parliament. Although laws enacted by the Republic of Iraq are routinely endorsed for application in the Kurdistan Region, there is no such endorsement in relation to the Federal Debt Law.

- Under the Kurdistan Debt Law, the Federal Government of Iraq is not liable for any obligations incurred by the KRG.

On the balance of the arguments, it is fair to conclude that neither the provisions of the Iraqi Constitution, nor the Federal Debt Law, prevent the KRG from entering into borrowing transactions, including guarantees.

Looking Forward

The Biwater transaction demonstrates that the new Kurdistan Debt Law provides a workable basis for sovereign borrowing by the Kurdistan Region. The Biwater transaction may be the first of many such financing transactions which are vitally important to rebuilding the economy in the Kurdistan Region.

Amereller has been active in Iraq since 2004 and currently has offices in country's three major cities, and the office in Erbil is staffed with local and international lawyers. Amereller regularly represents international lenders in financing transactions in Iraq. In particular, the firm has extensive experience in acting for development banks and export credit agencies.

If you would like more information about this topic then please contact us.

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