Reconstruction of Iraq: the Legal Framework

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On 22 May 2003 the UN Security Council effectively lifted all non-military sanctions against Iraq. Foreign companies are likely to play a significant role in the reconstruction of the Iraqi infrastructure which has been largely destroyed by the trade embargo and the war. Contrary to initial expectations, the United States is apparently not taking any measures systematically to exclude those states which adopted a sceptical stance on the war, including Germany, France and Russia, from the reconstruction projects. This article outlines the legal framework for supply contracts with Iraqi parties and places particular emphasis on ways to deal with the legal uncertainty following the collapse of Saddam's regime.

Fall of the regime – survival of the law?

On the invasion of Baghdad by the American troops and the establishment of a transitional administration, the exercise of state authority by the regime of Saddam Hussein came to an unexpectedly swift end. It is to be expected that an Iraqi constituent assembly will convene in the course of the next year or so and decide on a new Iraqi constitution which will replace the Iraqi Provisional Constitution of 1970. However, until the new Iraqi legislature is functioning, pursuant to international law and practice it must be assumed that the former Iraqi laws and regulations continue to apply, although the governmental authority which once enacted those pieces of legislation no longer exists. One exception relates to such laws which were adopted by Saddam's regime with a clear political objective and which contradict international principles of justice, including, in particular, human rights; such laws can no longer be applied, even without a formal abrogation.

Like most of the Arab states, Iraq has a civil law system the central codification of which is the Civil Code of 1951. The Civil Code is based mainly on the Egyptian and French models; in some provisions the influence of Islamic legal concepts is also apparent. The provisions of the Civil Code are, however, to a large extent supplemented by rules of public economic law which, in the past, have curtailed the scope of private economic activity and

restricted the economic activities of foreign nationals.[1] In view of the dominant role of the public sector – in 2000, the private sector generated just 20 per cent of the gross domestic product – and the extensive regulation of private economic activities, the Iraqi legal system is not yet tailored to the requirements of a free market economy. Furthermore, the UN trade sanctions effectively had brought international legal relations with Iraq to a standstill for more than a decade. At present, therefore, Iraqi parties cannot necessarily be expected to be experienced in the drafting and negotiation of international contracts.

If the US Administration pushes through its concept of transforming Iraq into a model Arab democracy, extensive economic and legal reforms will be required in addition to political reforms.[2] It is likely that Iraq will, in this case, follow the line of economic liberalisation and privatisation which is meanwhile followed by many countries in the Middle East and North Africa region. Apart from other issues, the civil and economic law will then have to be fully reformed and adjusted to the requirements of a free market economy, a process which has been under way for some years now in neighbouring Arab states and in Iran. Consequently, it is to be expected that the present legal situation – at least in some sectors – will undergo a fundamental change in the course of the restructuring of the state and the administration.

In view of the current uncertainty in the legal situation and the difficulty of predicting its future development, it is advisable to 'delocalise' any agreement entered into with an Iraqi party to the extent possible. Furthermore, a foreign party should aim at excluding the jurisdiction of the Iraqi courts and the application of rules of Iraqi substantive law.

Arbitration clauses

An arbitration clause allows the complete removal of a dispute from the jurisdiction of the state courts. However, this requires the courts to recognise such an agreement to arbitrate. Iraq is not a party to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 (the 'New York Convention'). However, the Iraqi Code of Civil Procedure (1969) contains a chapter on arbitration in articles 251-276. Pursuant to the Code of Civil Procedure, a matter can be subject to arbitration if it 'can be the subject of an amicable settlement' and to the extent 'the parties can dispose over their rights' (article 254). In view of these provisions, in the past it was assumed that in international commercial contracts the

[1] The Law on Commercial Agency No 51/2000, for example, is among the most restrictive laws in the Gulf region. Pursuant to article 4(1)(a) of this Law, activity as a commercial agent is limited to Iraqi nationals.
[2] The US Administration established a working group, 'Transitional Justice', for this purpose as early as July 2002, which consists of Iraqi and international legal experts and is to develop conceptions for the legal framework of a post-war order.

competence of the Iraqi state courts can be effectively excluded by agreeing on an arbitration clause.

The place and language of the arbitration proceedings should be determined in the agreement and the procedural rules to be applied by the arbitrators should be agreed. In view of the fact that the provisions on arbitration in the Iraqi Code of Civil Procedure no longer fully meet current requirements, a place of arbitration outside Iraq should be preferred, also in order to exclude a review of the arbitration proceedings and the award by Iraqi courts. When drafting the arbitration clause, care should be taken to ensure that recourse to the ordinary courts is clearly and unequivocally excluded, because an Iraqi court cannot necessarily be expected to construe such an agreement 'in favour of arbitration'.

It will in any event be difficult to enforce a foreign arbitral award in Iraq. The recognition of foreign arbitral awards is subject to Law No 4/1928, which regulates the recognition of foreign judgments and the provisions of which are analogously applied to arbitral awards. Pursuant thereto, the enforcement of a foreign arbitral award is not excluded from the start, however, in view of the limited functioning order of the Iraqi judicial system, such enforcement is at present likely to encounter considerable practical difficulties. Wherever possible, therefore, the payment terms in a supply contract should be drafted in such a manner that an enforcement of any rights in Iraq is not necessary.

Agreement of a place of jurisdiction outside Iraq

As an alternative to an arbitration clause, although it is much less desirable, an exclusive place of jurisdiction outside Iraq can be agreed. In most jurisdictions around the world, this is permissible if and to the extent that one of the parties does not have a general place of jurisdiction in the domestic country. As far as can be seen, Iraqi statutory provisions are not an obstacle to such an agreement of the place of jurisdiction being recognised, so that Iraqi courts will also respect such agreement of the place of jurisdiction. Nevertheless, it is possible that an Iraqi court will disregard such an agreement in fact; in the past few years, it was repeatedly reported that as a result of UN trade sanctions, Iraqi courts showed only little willingness to recognise foreign places of jurisdiction.

Choice of law

The principle of the parties' autonomy, which grants the parties in international legal relations the right to make the contract subject to a legal system of their choice, is also contained in Iraqi law. Although article 25(1) of the Iraqi Civil Code, which regulates the law applicable to

contractual obligations, contains a provision pursuant to which the law of the parties' joint place of residence or, in the absence thereof, the law applying at the place of formation of the contract governs an international contract, the Iraqi provision makes such application subject to the reservation that no other agreement between the parties exists. If another agreement does exist, the parties' agreement takes priority over the statutory provision. Thus, it is possible and advisable to include in a contract with an Iraqi party a choice of law clause and to determine contractually the law governing the contract.

Exclusion of the CISG

Iraq is a member of the United Nations Convention on Contracts for the International Sale of Goods (CISG) of 1980. Therefore, if the parties choose Iraqi law or the law of another CISG member state, Article 1(1) CISG stipulates that the provisions of this Convention are to be applied as a part of national law, unless the parties have expressly excluded such application. The question of whether it is right to follow the widespread trend to exclude application of the CISG cannot be answered in a general fashion, because this depends on the dispute settlement mechanisms of the specific contract. If a contract provides for the settlement of disputes by an international arbitral tribunal which is familiar with the CISG, a decision based on the CISG may be more efficient than a decision pursuant to the provisions of a legal system in which not all arbitrators feel 'at home'. If, however, the foreign party has accepted the settlement of disputes by an Iraqi state court, it is questionable whether such a court is experienced in interpreting the CISG; this applies, in particular, in view of the fact that as a result of UN sanctions international legal relations, too, have largely come to a standstill.

Choice of 'internal' law?

If the parties decide to exclude application of the CISG, the question arises by 'whose law' the contract shall be governed. In this instance, naturally, the foreign supplier will favour the application of its own law. However, it will be difficult to get this through in many cases, because the buyer (not quite without justification) will raise the objection that the seller's law is to the buyer's disadvantage. On the other hand, an argument against a choice of the provisions of Iraqi law is that the foreign supplier does not know this law and that the specific application of individual Iraqi legal provisions – at least at present – can hardly be ascertained with sufficient certainty. Furthermore, it is likely that no court decisions of Iraqi courts exist with regard to many questions being raised by a complex international contract. There is a strong recommendation, therefore, to refrain from choosing Iraqi law, and this applies in the

interest of both parties. What remains to be resolved is the agreement on a 'neutral' legal system to govern the contract. However, the choice of a neutral law is also not quite without disadvantages. In this case, both parties are equally unfamiliar with the applicable law, which leads to uncertainty and increases the transaction costs if the content of the neutral law has to be established.

Full and complete contractual arrangement

If the question of choice of law cannot be solved to the satisfaction of all parties, it is often possible largely to defuse this problem by making a contractual arrangement which is as comprehensive as possible. Only a few mandatory provisions restrict the freedom of drafting international commercial contracts, and it is a matter of making use of this leeway in order to exclude undesirable or incalculable principles of a state legal system. It is, therefore, recommendable to include in the contract – in addition to the subject matter of the sale, the purchase price and the terms of delivery – detailed provisions governing defect warranty, acceptance and notice of defects in order to reduce the significance of state legal provisions to a minimum; however, this does not allow a circumvention of the mandatory provisions applicable to the contract, to the extent that they are of relevance in the context of international supply agreements.

TExport control

The comprehensive UN trade sanctions,once levied through UN Resolution 661 of 6 August 1990, were effectively lifted on 22 May 2003 (with the exception of the sanctions relating to the supply of military supplies). However, this does not imply that the national export control regulations, which transformed the UN Resolution into binding law in many jurisdictions (eg the laws and ordinances enacted in the EU on basis of the EC Ordinances Nos 3541/92 and 2465/96) are no longer in force. Pursuant to national export control regulations, trade with Iraq often continues to be permitted only under strict conditions and with a respective export permit of the competent national export control agency[3]. The embargo regulations (or the norms of the European and national law implementing these regulations) are mandatory rules, and a contract infringing them is void (even in case the contract, by way of a choice of law clause, is governed by a legal order which did not recognise the embargo).. In order to avoid this legal consequence, it is normally required (and also sufficient) to make the effectiveness

[3] As is the case in Germany, where the Artt. 52, 69a and 69e of the Foreign Trade Ordinace („*Aussenwirtschaftsverordnung"*) continue to be in force; in the UK, however, the Department of Trade and

of the contract subject to the condition precedent that the sanctions are waived, ie the contract with the Iraqi partner will only become effective when it no longer infringes applicable export control regulations. Thus, in case of a contract being entered into prior to the formal lifting of the trade sanctions, a conflict with the relevant foreign trade and payment provisions can be avoided.

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Industry (DTI) has issued two Open General Licenses effectively removing the need for expoerters to apply to the DTI for export licenses.