

Update

Doing Business in Iraq



Summary

- The legal standing of contracts is uncertain.
- Political risk insurers of equipment and contract frustration prefer short term deals.
- Iraqi oil and gas risks represent a new income stream for insurers.
- Pre-risk surveys are likely to be a prerequisite.
- Capacity may be limited for sabotage and terrorism cover.
- Contract negotiations should specifically address environmental responsibilities.

With the major conflict in Iraq now at an end, many businesses will be considering ways to access the opportunities presented by the need to reconstruct and develop Iraq and its infrastructure. Our Adviser in March focused on the immediate risk considerations for UK businesses. Here we summarise the insurance implications, taking into account local Iraqi regulation and underwriters' appetite for the risks involved. An important point here is that, while underwriters say they are prepared to cover Iraqi risks, their ability to do so depends on the removal of sanctions and establishment of a stable regime.

Local Iraq Insurance Market & Regulation

There are numerous pieces of legislation regulating the insurance industry in Iraq dating back to 1921, all of which are in Arabic without official English translations. However, in summary, all insurance must be placed with one of the local Iraqi insurers. These are listed in the table to the right.

Company	Authorised ¹ capital	Paid up capital	General reserves	Technical reserves
National Ins Co	20,000	20,000	210,409	6,591,653
Iraq Ins Co	50,000	50,000	77,672	1,225,375
Iraq Reinsurance Co	10,000	4,129	15,511	842,379
Dar al-Salaam Ins Co	250,000	-	-	-
Ahlia Ins Co	50,000	-	-	-
Al-Ameen Ins Co	150,000	-	-	-
Al-Hamra'a Ins Co	30,000	-	-	-

all figures IQD '000s

Source: AXCO

Dar al-Salaam, Ahlia, Al-Ameen and A-Hamra'a are private companies which were set up following a change in law in 1997. This allowed the establishment of private Iraqi companies but not international one. It is not known, however, if these new companies have transacted any business since being formed in 2001. The remaining companies - National Insurance Company, Iraq Insurance Company and Iraq Re - are all state owned.

¹ (Official rate of exchange remains at USD 3.2249 to IQD 1 whilst the black market has now fallen to over IQD 2,000 to USD 1).



The imposition of sanctions meant that Iraq Re and the other local insurers were unable to retrocede any liabilities to the international market. Iraq Re writes all business for its own account with an agreed maximum loss irrespective of sums insured.

Political Risks

One of the most difficult aspects of undertaking business in post-conflict Iraq is the current uncertainty regarding the legal standing of contracts that were arranged with the previous regime or are now being negotiated.

A number of well-publicised contracts were made with the outgoing regime. It is arguable whether these remain valid. The old regime acted in breach of international law, particularly United Nations Resolution 1441. This led to the sanctions imposed by UN Security Council Resolution 661, and individual countries may have enacted their own legislation to give these sanctions validity within their jurisdiction. Thus the validity of any contract made with the old regime must be considered in terms of both national and UN legislation/regulation. On 26 May the US appointed Iraq oil minister announced that several oil production contracts made with the old regime would be terminated or frozen.

The most recent US, UK & Spanish sponsored UN Security Council resolution, number 1483 adopted on 22 May 2003 made significant progress towards clarifying the standing of contracts, particularly for oil & gas related companies, seeking to undertake business in post-conflict Iraq. The main points to note in this respect are:

- The establishment of a Development Fund for Iraq. This fund will be administered by the Central Bank of Iraq and audited by independent public accountants, approved by the International Advisory and Monitoring Board of the Development Fund, which would include representatives of the Secretary-General, the International Monetary Fund (IMF), the World Bank, and the Arab Fund for Social and Economic Development. Resources of the Development Fund would be disbursed at the direction of the Authority (the occupying Powers under unified command), in consultation with the Iraqi interim administration, for humanitarian, reconstruction, disarmament and civilian administration purposes. Refer to section 12 of the above referenced resolution.
- That petroleum, petroleum products and natural gas originating in Iraq are subject to a wide-ranging immunity from legal proceedings until 31 December 2007 - refer to section 22 of the above referenced resolution.
- The 'Oil for food' programme has been extended for a further six months. Refer to section 16 of the above referenced resolution.

None the less companies must assess the likelihood of future administrative authorities recognising contracts made under any current provisions. Careful consideration should be given to 'contract frustration' and 'force majeure' provisions within their contracts.

The political risk insurance market can provide three core products.

Comprehensive Contractors Plant & Equipment

This insurance covers mobile plant and equipment losses arising from terrorism, abandonment, deprivation, expropriation, war, strikes, riots and civil commotion. Likely purchasers include construction companies, machinery leasing firms and temporary power suppliers.

Underwriters are currently focusing on providing this cover for contractors working on Iraqi oil/power restructuring programmes and generally view proposals as medium risk or medium/low risk, depending on where activities are located. They see loss of plant and equipment in Shia dominated areas as being medium risk while the medium/low risk areas are the Kurdish areas and Kuwait border regions. Political risk insurers are most receptive to providing this cover for short-term (three to six months) contracts where there is good security and where the nature of the contract is not likely to provoke local instability.

Contract Frustration

Political risk insurers will also consider providing contract frustration cover in Iraq. This protects companies against losses arising from non-payment by a foreign government or inability to complete a contract because of the actions or inactions of another party. Triggers include non-certification, licence cancellation, export/import embargo and war. Insurers are mainly interested in underwriting shorter term (six months) contracts that involve pre-financing of crude oil export deals, similar to those arranged under the oil for food programme.

Underwriters will also consider providing cover against pre-shipment perils where these are associated with restructuring projects backed at a senior level by national governments. There is also some appetite for post-shipment risks relating to major projects or the oil industry.

Equity Investment and Lenders' Interest

As regards equity investments and lenders' interests, underwriters are not yet prepared to cover the typical risks of expropriation, forced divestiture, abandonment and non transfer or currency inconvertibility in respect of Iraq. Companies are most likely to require this type of cover where they plan to use revenue from an overseas investment to repay the intra-company or bank loans that they raised to finance that investment. However, it is unlikely to be available until Iraq establishes a stable, internationally recognised regime.

Physical Risks

Underwriters generally are concerned that the potential for loss or damage in Iraq may be high. This is because Iraqi operations have not had access to recent technical risk improvements, nor to the spares and inventory necessary for normal levels of maintenance and the efficient running of the business. Unexploded ordnance and continued pockets of resistance will also present a threat for some time to come.

The early days of Iraq's regeneration are likely to involve companies in a number of industry sectors, most important of which will be: oil and gas; power and utilities, and construction of these facilities.

Oil & Gas

There appears to be no reason why the total underwriting capacity for oil and gas operations in Iraq should not match

that available for the rest of the world, assuming that individual countries, as well as the UN, lift sanctions. Indeed, underwriters' appetite for Iraqi risks may well be high since these represent a new income stream at a time when insurers are finding income targets increasingly difficult to achieve.

Insurers' acceptance of risks will reflect their assessment of the operators or contractors involved in the normal way. However, we do not anticipate any selection against Iraqi based new assets under construction, operational assets or drilling programmes, other than for sabotage and terrorism and a possible loading on transit risks due to poor infrastructure.

Similarly, we expect policy wordings to be the same as for other territories. However, rating levels are likely to be higher than elsewhere for existing assets and wells unless the pre-risk survey demonstrates that the facilities and wells are within an acceptable international benchmark. Insurers may also impose higher deductibles and restrict or limit certain coverages.

While standard onshore property policy forms will exclude terrorist risks, there are specialist markets that will underwrite onshore terrorism risks on a stand-alone basis. See below for details. Offshore terrorism cover is currently available through normal panel underwriters but with sublimits and additional premiums that are significantly higher than base rates.

Insurers are likely to insist upon pre-risk surveys for existing assets both on and offshore. For exploration and production (E&P) risks, they will focus on well casing, pipe and blow out prevention integrity, as well as any environmental risks, and will require full information on any existing pollution.

In connection with offshore construction all risks cover, insurers do not have any problems with providing cover in the Arabian Gulf itself. They know the area and it does not produce any significant technical difficulties. Consequently, their focus will be on the Iraqi personnel involved, both employees and contractors - and their skills, training, management. Equally, project management and quality assurance/quality control procedures and plans will be subject to detailed scrutiny. They will also take account of the infrastructure, including ports, fabrication and storage facilities. Inland transportation routes and the appropriateness of equipment will also require careful presentation.

Onshore energy construction is the one market that may find insurance capacity limited as underwriters in this area are currently experiencing high demand for cover. Companies may therefore have to take higher retentions than normal in order to increase insurers' interest in Iraqi business. Underwriters will also exclude any losses from sabotage and terrorism and, if they are prepared to cover strikes riots and civil commotion, will probably provide only low limits.

Insurers providing control of well policies are unlikely to include extended redrill coverage. They may even exclude redrilling altogether on old wells, providing only blow-out cover for these. Where they do provide redrill cover, this is likely to be on an aggregated losses basis.

Insurers may also seek to exclude pipeline risks, particularly those below ground. Certainly, these would require detailed risk assessment.

Power and Utilities

Subject to the lifting of sanctions, we anticipate again that the total capacity available for Iraqi power and utilities operators will be the same as for the rest of the world. Underwriters will focus here on the type of machinery, equipment and generation unit involved, the mix of local/expatriate employees and contractors, and the date of plant commissioning or recommissioning. Again pre-risk surveys are likely to be a prerequisite.

We expect the breadth of coverage to be the same as in other parts of the world except in respect of specific issues relating to business interruption and machinery breakdown. Insurers are likely to exclude costs associated with prolonged delay of imports from business interruption cover in certain circumstances - for example, where the delay results from such things as slow clearance by import authorities or poor local infrastructure. Both business interruption and machinery breakdown policies are likely to exclude costs related to high import duties and taxes.

Deductibles too are likely to be higher than in other parts of the world, reflecting insurers' lack of familiarity with Iraqi risks.

The key to securing capacity and support in these markets will be in anticipating underwriting concerns and producing detailed risk information and scope of work data.

Sabotage and Terrorism

While there is a market for sabotage and terrorism insurance in Iraq, insurers are not prepared to cover government-owned buildings, including embassies. And they prefer short term contracts of up to six months.

Since insurers perceive US-owned property as being a more likely target than that owned by companies in other countries, including the UK, they will rate the sabotage and terrorism premium accordingly. Capacity is generally likely to be limited. In addition, as there is no consensus on rating levels at present, companies should not view any indications on premium as definite until the cover is fully placed.

The lack of clarity regarding government and administrative authority could also present difficulties with policy wordings. Current market wordings typically relate to acts of violence against a government as illustrated by the following example:

"an act of terrorism means an act, including the use of force or violence, of any person or group(s) of persons, whether acting alone or on behalf of or in connection with any organisation(s), committed for political, religious or ideological purposes including the intention to influence any government and/or to put the public in fear for such purposes."

In the absence of a recognised Iraqi government, an underwriter may argue that an act of violence is vandalism or malicious damage as opposed to terrorism. However, it is unlikely that normal property policies that include vandalism or malicious damage would accept this argument. Terrorism insurers will probably need to amend standard wordings to reflect the current situation in Iraq.

It is likely, however, that the provision of terrorism coverage in Iraq will be subject to an independent security review.



Environmental Risks

The much-feared potential environmental catastrophe - the firing of the Iraqi oil fields during the conflict - did not happen. However, the long period of sanctions, the low priority given to environmental issues and the war itself all contribute to the likelihood of businesses operating in Iraq encountering some form of environmental risk. This, coupled to the general uncertainty on legal rights of ownership and liability, means that all contract negotiations should specifically address environmental responsibilities.

Until recently, all environmental underwriters have excluded Iraq. This situation recently changed, with one major international insurer expressing willingness to cover Iraqi risks. However, since environmental policies are triggered by statutory intervention, underwriters will need to familiarise themselves with Iraqi legislation before they can offer cover. Additionally, environmental risk insurers do not only exclude countries purely on the grounds of legislation, but also because they lack confidence in the government and its stability, as is the case with Haiti and Afghanistan. It is therefore possible that restrictions on Iraq may remain following the lifting of economic sanctions.

Cargo

All cargo shipments of oil currently remain subject to the UN legislative orders under the oil for food programme. Whilst the existence of this remains unclear it is unlikely that underwriters will not offer coverage for any shipments that are not cleared via the UN programme. Already there have been threats of legal action against cargo and ship owners/charterers for any off-take of Iraqi oil.

More generally it is expected that priority may be given to project/infrastructure investment cargoes in respect of which Underwriters will be concerned about the local capability to provide the level of expertise necessary to undertake supervision warranty surveys. If local expertise is not available then this will have a cost implication to any assured as fees are generally for the account of an Assured and therefore the expertise will have to be brought in from another country.

Additional attention is likely to draw on the exact routing of cargoes as there may be concerns/additional risk and hazards over unexploded ordnance. Whilst Institute Cargo War Clauses provide cover against unexploded ordnance, these clauses are limited to coverage whilst the cargo is afloat. This is not however the case whilst the cargo is on land. In this instance cover is only provided for Strikes Riots & Civil Commotion (SRCCC). Therefore clients should pay close attention to routing, hauliers and trucks that are likely to be employed for the overland movement.

Visiting Iraq

A British Diplomatic presence was established in Baghdad 5 May but is unable, at this time, to offer consular assistance. The current Foreign and Commonwealth Office advice is against any attempt to travel to this territory.

This does not mean that travel insurers will necessarily exclude visits to this country. However, any such visits will be material information and the travel and personal accident insurer will require prior advice before cover can be considered. Checks should also be made with the insurer for any additional restrictions on cover that may be imposed. The Employers' Liability (EL) insurance should include all temporary visits abroad although, again, visits to Iraq must be advised to the EL insurer prior to the trip as material information.

For further advice and assistance on this issue, please contact your usual Marsh representative.



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