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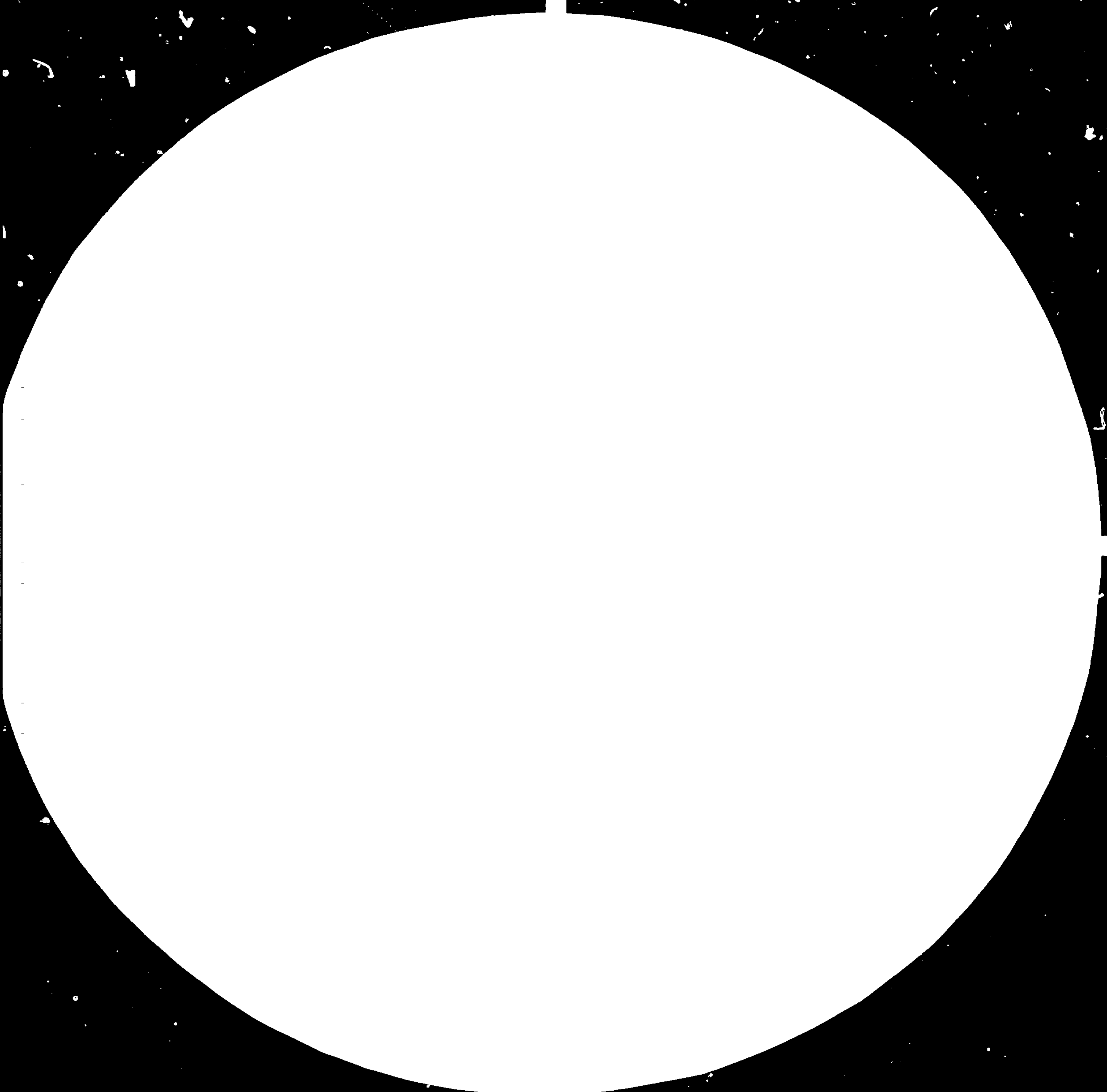

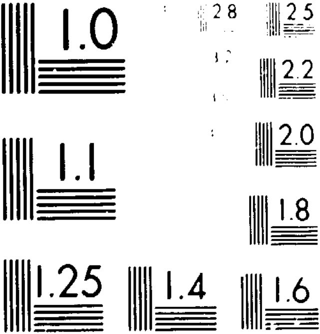
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Third Consultation on the Fertilizer Industry
São Paulo, Brazil, 29 September - 4 October 1980 1/

Agenda Item 5

ESTABLISHING A MULTILATERAL INSURANCE SCHEME PROVIDING ADEQUATE COVERAGE FOR CONSEQUENTIAL LOSSES INCURRED BY FERTILIZER AND OTHER INDUSTRIAL PLANTS 2/

Proposal by the

UNIDO Secretariat

1/ As will be explained in the note for participants, the duration of the Consultation has been extended to 4 October 1980.

2/ This document has been reproduced without formal editing.

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CHAPTER I

HISTORY OF THE PROPOSAL TO ESTABLISH A MULTILATERAL INSURANCE SCHEME

1. The need to establish a multilateral insurance scheme that will provide adequate compensation for consequential losses incurred by fertilizer and other industrial plants built in developing countries has been recognized since 1975.

2. At the Second General Conference of UNIDO in Lima, Peru in March 1975, developing countries prepared a draft resolution concerning the establishment of an insurance system for guaranteeing contracts concluded by the developing countries with enterprises from the developed countries, which declared that "it is essential for the promotion of just and balanced international economic relations that the Governments of the developed countries should establish an insurance system to protect the developing countries from the risks to which the latter are exposed in their industrial co-operation with the developed countries".

3. This resolution was not adopted by the Conference; instead it was referred to the Industrial Developement Board UNIDO's Governing Body,1/ which limited its action to noting the action taken by the First Consultation on the Fertilizer Industry in recommending further study of a multilateral insurance scheme for the fertilizer sector2/.

4. The Preparatory Meeting for the First Consultation on the Fertilizer Industry recommended that the First Consultation should consider various steps needed to ensure that modern and efficient fertilizer plants that are reliable to operate are constructed in developing countries. One of the steps suggested was that Governments, fertilizer manufacturing enterprises, international contractors and suppliers of equipment should agree to co-operate with UNIDO in elaborating detailed proposals for establishing a multilateral insurance scheme to cover risks and consequential losses derived from defects in the design of plant and equipment3/.

1/ Report of the Second General Conference of UNIDO, ID/CONF.3/31, paras.300-302.

2/ Report of the Eleventh Session of the Industrial Development Board, 15 June 1977, paras. 176-179, page 32.

3/ Issues to be considered by the Consultation Meeting, ID/WG.242/2.

5. The First Consultation on the Fertilizer Industry examined this proposal, supported the intentions underlying the proposed multilateral insurance scheme, but realized that practical difficulties might arise in its implementation. It therefore recommended that the practical aspects of such a scheme should be subject to more intensive examination and investigation in conjunction with further work on contract procedures[1/].

6. When reporting on work on this subject to the Second Consultation[2/], UNIDO's assessment was that the world commercial insurance market could insure only the consequential losses resulting from material damage or mechanical breakdown incurred by fertilizer plants. As insurers were unlikely to insure other causes of consequential loss, the UNIDO Secretariat suggested that the guarantee of the performance of fertilizer plants might best be given by the Government of the supplier's country.

7. At the Second Consultation, participants from developing countries supported this proposal of the UNIDO Secretariat because the failure of fertilizer plants had a serious effect on fertilizer supplies and the balance of payments of their countries. Participants from developed countries with market economies felt that the Government should not be involved in providing such guarantee[3/].

8. Considering the conflicting views and accepting the above respective positions, the Second Consultation recommended that:

> "UNIDO should collect additional information on the amount and causes of consequential losses in fertilizer plants and, on the basis of that information, continue to examine with contractors, insurers, Governements and other interested parties, how appropriate solutions to the problem might be reached[4/]".

1/ Report of the First Consultation, ID/WG.242/8 Rev.1 paras 38 and 64.

2/ The Progress made in implementing the follow-up action recommended by the First Consultation, ID/WG.281/13 paras 18-30.

3/ Report of the Second Consultation, ID/WG.281/18/Rev.1 paras. 19-20.

4/ ID/WG.281/18/Rev.1 para.21.

CHAPTER II

THE AMOUNT AND CAUSES OF CONSEQUENTIAL LOSS IN FERTILIZER PLANTS

9. A questionnaire that was designed by the Working Group on Contracts and Insurance in February 1978, was sent to 39 enterprises in developing countries who had acquired and operated fertilizer plants over the period 1965-1977. Answers were received from 25 companies realting to 37 plants. Complete information was provided for 27 plants producing the following products:

Ammonia/Urea	:	18 plants
Ammonia	:	4 plants
Phosphoric acid	:	1 plant
SSP/TSP	:	2 plants
NPK compounds	:	2 plants

10. Plant owners were invited to provide information for the first three years of operation relating to: (i) actual production achieved; (ii) production losses due to design defects; (iii) production losses due to mechanical breakdown; and (iv) production losses due to other causes. The other causes listed were: annual shutdown and other planned shutdown, raw material quality, interruption of raw material supply, no power, no spare parts, no market off-take and other causes.

11. The experience of the 27 plants surveyed showed the actual loss of production in the first three years of plant operation, calculated as a percentage of nameplate capacity was as shown in Table I[1/].

12. A published survey of ammonia plants built in the United States and Canada in the period 1969-1976 provides comparable information, shown in Table II. In North America one-third of the maintenance turn-arounds was initiated by a major equipment failure; in these cases, the time required to repair the major equipment item causing the shutdown was allotted to "major equipment failures" and the remaining turn-around time to "preventive maintenance"[2/].

1/ A technical description of the design defects, causes of mechanical breakdown and the resulting loss in production were given in the Report of the Meeting of Experts on Insurance on Consequential Losses incurred by Fertilizer Plants held in September 1978, ID/WG.284/1, pages 18-25.

2/ The 30 plants covered in 1975 and 1976 represent 83 per cent on the large tonnage ammonia units on stream in the United States and Canada before 1975. G.P. Williams, "Causes of Ammonia Plant Shutdown", Chemical Engineering Progress, September 1978, pages 88-93.

13. The UNIDO questionnaire also asked whether the plant owner had sought and obtained compensation for losses due to design defects either (a) from the contractor, (b) from insurance and (c) through litigation. Where design defects were reported, most claims were settled through negotiations between the Purchaser and the Contractor. The only insurance claims reported were for damage resulting from fire. There were only two cases of litigation. These responses suggest:

(a) that the contractual remedies available to the plant owner covered only rectification of the defect, and that this was not always carried out expeditiously;

(b) that the plant owner resorted to litigation only in cases where the contractor failed to complete the project.

14. Thus the experience of the 27 fertilizer plants survey confirms the need to cover the risks which the multilateral insurance scheme proposed in this paper is intended to cover.

TABLE I. CAUSES OF PRODUCTION LOSS IN DEVELOPING COUNTRIES 1/

Production losses due to:	18 Nitrogen Fertilizer Plants	9 Phosphate Fertilizer Plants
	per cent	per cent
Design defects	4.1	-
Mechanical Breakdowns	15.5	19.2
All other causes	15.5	34.5
Total lost production	35.1	53.7
Operating rate	63.9	46.3
	100.0	100.0

TABLE II. PRODUCTION LOSSES IN NORTH AMERICAN AMMONIA PLANTS 1/

	1969/70	1971/72	1973/74	1975/76
Number of plants	22	22	30	30
Production loss due to:	per cent	per cent	per cent	per cent
Mechanical Breakdown	9.4	6.4	8.3	7.6
Preventive Maintenance	4.8	7.1	5.4	7.5
Total loss of production	15.1	13.8	14.8	15.1
Operating rate	84.9	86.2	85.2	84.9
	100.0	100.0	100	100.0

1/ Loss of production calculated as a percentage of nameplate capacity.

CHAPTER III

RESULTS OF UNIDO'S DISCUSSION WITH GOVERNMENTS

15. The export credit insurance agencies of many industrialized countries[1/] were invited to participate in the initial discussion of the multilateral insurance scheme at the Working Group on Contracts and Insurance convened in February 1978. At that time, the Agencies represented saw little prospect of participating in a scheme designed to assist the Purchaser not the Supplier.

16. To explore the matter further, an official of the UNIDO Secretariat and two consultants visited the export credit insurance agencies of Belgium, Federal Republic of Germany, France and the United Kingdom as well as the Commission of the European Communities and the Berne Union in February 1980. They reported on the multilateral insurance scheme that was being developed for presentation to the Third Consultation. They further suggested that the Agencies could help UNIDO achieve its objective if (a) the Purchaser's obligations to repay a guaranteed loan were to be conditional on satisfactory completion of the Contractor's obligations and (b) in the event of any delay in completion caused by the Contractor, repayment of loan should be postponed and the resulting interest charges added to the guaranteed loan.

17. The Agencies consulted reported that a Purchaser's obligation to repay his loan was unconditional in the case of a Buyer's Credit because the credit was arranged directly by the Purchaser with the banks supplying finance who in turn received a gurantee of repayment by the Purchaser from the export credit insurance agency. The Agency generally concluded a recourse agreement with the Contractor as a condition of guaranteeing the Buyer's Credit. Under a Supplier's Credit repayments by the Purchaser to the Contractor are guaranteed by the Agency, conditional on his demonstrating that he has fully complied with his obligations under the Contract.

1/ Hereafter such agencies are referred to as"the Agency or "the Agencies".

18. UNIDO's second suggestion was that there should be more flexibility as regards the date when repayments of loans started. The Agencies consulted reported that they followed the definition that the Berne Union had adopted to decide whether or not a transaction should be reported as involving a credit longer than 5 years. This states that:

> "In the case of any contract where the supplier or contractor has a contractual responsibility for commissioning, the starting point is the date when he has completed installation or construction and preliminary tests to ensure that it is ready for operation. This applies whether or not it is handed over to the buyer at that time in accordance with the terms of the contract and irrespective of any continuing commitment which the supplier or contractor may have; e.g. for guaranteeing its effective functioning or for training local personnel".

The Agencies reported that they would sympathetically consider a rescheduling of loan repayments, if the delay were the Contractor's fault; however, it was more difficult to increase the size of the loan to include the additional interest payments that the Purchaser would then have to bear.

19. Discussions also revealed that the Agencies consulted offer insurance of Contractor's bid/tender, performance and advance payment bonds. Under this programme, they idemnify the Contractor for losses resulting from an "arbitrary" or "unfair" calling of an "on-demand" performance bond. In the United Kingdom, a call is considered "unfair" if it is made at any time when the exporter is not in default under the terms of his contract, or if any failure to perform is due to specified causes outside his control. Under its indemnity, the Agency is generally unconditionally liable to reimburse the bond giver in full or for 90 per cent of the amount of a bond call. A typical premium payable for such support is 1.25 per cent per annum of the face value of the bond. A similar programme is offered to Contractors in the United States by the Overseas Private Investment Corporation which issued three such policies in 1979.

20. One country which has gone some way towards guaranteeing the performance of the supplier on a very small part of its total export business is Canada, through the Canadian Commercial Corporation, which is a government entity with authority to negotiate contracts direct with foreign buyers. This Corporation then negotiates what is in effect, a total sub-contract with a Canadian supplier but the Corporation stands as the prime contractor to the Purchaser. This is one precedent for direct Government involvement in the guarantee of performances of goods and services supplied to the Purchaser.

21. When the Purchaser suffers consequntial losses (including additional interest payments on loans outstanding) resulting from

(a) A delay or delays in completion of the plant;
(b) The failure of the completed plant to fully perform in accordance with contract specifications and technical data due to causes for which the Contractor and suppliers are responsible.

the Purchaser will face a strain on his financing that could result in a delay in repayments of a credit which the Agency has guaranteed as a Buyer's or Supplier's Credit for the project.

22. UNIDO therefore suggests that export credit insurance agencies might well be interested in a multilaterial insurance scheme which compensates the Purchaser for consequential losses and thereby helps both the Purchaser and the Contractor to avoid serious financial difficulties. At the same time UNIDO recognizes that the statutes, power, structure and functions of such Agencies varies from country to country and that new legislation would usually be required to permit such Agencies to engage in insuring the interests of the Purchaser as opposed to those of the Contractor or Supplier which are covered at present.

23. The multilateral insurance scheme proposed in this paper is likely to be considered collectively by the Agencies. All of the Agencies and similar agencies in seven developing countries are members of the Berne Union, or to give its correct name, the International Union of Credit and Investment Insurance (see Annex A). Founded in 1934, the main objects of the Union are to work for the international acceptance of sound principles of export credit and investment insurance. The Berne Union monitors the export credits provided by Governments; both OECD and the World Bank use the data it collects.

24. The Export Credit Group of the OECD Trade Committee re-inforces at Government level, the work of the Berne Union. It normally meets twice a year at OECD Headquarters in Paris. Export credit forms part of the common commercial policy of the European Economic Community where it is the concern of a Council Policy Co-ordination Group for Credit Insurance, Credit Guarantees and Financial Credits . An International Consensus on Export Credits which sets guidelines for minimum rates of interest and down-payments and maximum lengths of credit, was agreed in June 1976. Although it is not a formal OECD agreement, all the countries that participate in the OECD Export Credit Group now subscribe to the arrangement, with the European Economic Communities doing so as a single entity[1/].

1/ In the field of investment insurance the Commission proposed in 1978 that investment in developing countries in the mining and later on in other sectors of the economy could be covered by a self-financing community-wide investment protection scheme which would have the guarantee of the Community Budget in the case of excess losses. The proposal has not so far been approved for implementation. See Necessité et Orientation d'Action Communitaire d'Encouragement des Investissement Européene dans les Pays en Voie de Developpement, Comm (78) 23 Final, 26 January 1978.

CHAPTER IV

RESULTS OF UNIDO'S DISCUSSIONS WITH CONTRACTORS

25. The purpose of the multilateral insurance scheme is to cover risks that are not borne by the Contractor or by insurance which is currently available from the world commercial insurance market.

26. UNIDO's discussions with contractors relate to the scope and conditions of the UNIDO Model Forms of Contract for the Construction of a Fertilizer Plant which are being considered under Agenda Item 4 at the Consultation. The liabilities which the Contractor will accept will become clear through the discussion of the Model Contracts at the Consultation.

27. In the UNIDO Model Contracts, the Contractor is liable to the payment of liquidated damages for default in his responsibilities as regards:

(a) Delivery of the technical documents;
(b) Delay in mechanical completion;
(c) Delay in commercial production;
(d) Non-fulfilment of guarantees of the plant's performance.

The total liability of the Contractor under the contract is normally limited and in the UNIDO Model Contracts (Article 30.5) shall not exceed a percentage of the total project cost (to be negotiated) or a specified monetary sum (to be negotiated) whichever is the greater. The Contractors have informed UNIDO that the normal limit is 10 per cent of the project cost in a Turn-key contract and a lower figure where the Contractor assumes less responsibility. However, the Contractor's liability for the fulfilment of warranties, the performance guarantees which are termed "absolute guarantees", modifications and completion of the works are excepted from this limit on the Contractor's liability in the UNIDO Model Contracts.

28 The Contractor is not liable for any loss of anticipated profits or any consequential loss of damage arising from any cause (Article 30.6). The only exception is the Contractor's obligation to repay to the Purchaser any amount receivable from insurance policies held by the Contractor covering such consequential losses. The insurance covers which might be held by the Contractor are listed in Article 24 and considered in Chapter V of this paper.

29. As regards the completion by the Contractor of his obligations in the contract, the Contractor is expected to provide a performance bond for a negotiated amount in favour of the purchaser in the form given in Annexure XXII.[1/] The type of performance bond suggested requires that when the Contractor is in default under the contract and provided the Purchaser has performed his obligations, the Surety shall either promptly remedy the default, promptly complete the contract or arrange for it to be completed. In other words, the Surety is required to complete the plant if at all possible. The performance bond does not cover consequential losses resulting from delay in completion of the project or non-performance.

30. For some types of industrial contract other types of performance bond may be used. There is an "on demand bond", where the bond may be called without necessarily proving non-performance by the Contractor and a "conditional bond", where the bond can be called only after the Contractor himself has admitted, or an arbitrator or other third party has ruled, that he is in breach of contract.

31. The protection of the interests of the Purchaser will depend on the terms and conditions of the bond and the amount of the bond which will be negotiated. The amount of the bond will depend on the type of contract and will be discussed under Agenda Item 4 at the Consultation. In current practice , it does not usually exceed 25 per cent of the contract price;[2/] this is 25 per cent of the project cost in the case of a Turn-key contract but much less for contracts where the Contractor assumes less responsibility.

1/ Of the Annexures to the UNIDO Forms of Model Contract.

2/ Communication of the World Bank to UNIDO, February 1978.

32. Some Contractors have informed UNIDO that they view their role as a supplier of professional services related to the design and engineering of fertilizer plants. As such, many Contractors do not have the financial strength to be able to take on contracts with large potential liabilities; as a general rule they cannot accept liabilities greater than those included in the UNIDO Model Contracts.

CHAPTER V

RESULTS OF UNIDO'S DISCUSSIONS WITH INSURERS

33. Insurance experts from developed and developing countries attended a Meeting of Experts on the Insurance of Consequential Losses incurred by the Fertilizer Plants in September 1978. They identified the following insurance covers as available to the Purchaser and Contractor:

Contractors/Erection All Risks Insurance (EAR) including testing/breakdown coverage and Loss of Advance Profits extension.

Transit Insurance (Marine, Land or Air) extended to include Loss of Advance Profits insurance.

Machinery Breakdown Insurance (Completed Plant) extended to include Loss of Profits insurance.

Property Insured - Fire and Allied Peris (Completed Plant) extended to include Loss of Profits insurance.

General Liability (Third Party) Insurance .

Liability Insurance (during completion of Project);automobiles, aircraft and marine liabilities (as appropriate).

Professional Indemnity Insurance of Contractor(s).

34. They summarized the coverage of these insurance as shown in Table III and noted that many Purchasers were not in a position to be aware of some of the covers available in the insurance market.

35. The experts prepared an analysis of major exclusions in insurance covers shown in Table IV.

36. When UNIDO called a different group of insurance experts in early 1980 to review these findings, they confirmed that the main gaps in existing insurance covers were as follows:

(a) Financial, consequential losses due to faulty design, faulty workmanship and/or faulty material not giving rise to material damage;

(b) Consequential losses arising from non-compliance with the guaranteed performance of the plant, if the losses are beyond the performance bond and liquidated damages or penalty as specified in the contract;

(c) War,major political risks and nuclear incidents.

TABLE III **INSURANCE AVAILABLE TO COVER MATERIAL DAMAGE AND CONSEQUENTIAL LOSSES**

Risk Covered	During Plant Construction		During Plant Operation	
	Material Damage	Consequential Loss	Material Damage	Consequential Loss
Fire and Allied Perils	Standard EAR Policy	Advance Loss of Profits Policy	Fire Policy	Fire Loss of Profits Policy
Mechanical and Electrical Breakdown	Standard EAR Policy	EAR Advance Loss of Profits Policy	Machinery Breakdown Policy	Machinery Breakdown Loss of Profits Policy
Faults in Erection	Standard EAR Policy	EAR Advance Loss of Profits Policy	Machinery Breakdown Policy	Machinery Breakdown Loss of Profits Policy
Manufacturer's Risk a) Material damage resulting from faulty design, faulty workmanship and faulty material	Endorsement to Standard EAR Policy	Not available for design faults	After expiry of guarantee period included in Machinery Breakdown	After expiry of guarantee period included in Machinery Breakdown Loss of Profits Policy
b) Financial Losses due to faulty design, faulty workmanship and faulty material without material damage	Not applicable	Not available	Not applicable	Not available

SOURCE: Report of the Meeting of Experts of the Insurance of Conseuqential Losses Incurred by Fertilizer Plants, Vienna, 18-20 September 1978 (ID/WG.284/1)

Note: EAR = Erection/Construction All Risks

Table IV : MAJOR EXCLUSIONS IN EXISTING INSURANCE COVER

	Material Damage before Handover	Consequential Losses before Handover	Material Damage after Handover	Consequential Losses after Handover First 12 Months 1/	Consequential Losses after Final Handover Following Period
1. War, major political risks and nuclear incidents	x	x	x	x	x
2. Normal wear and tear including corrosion	x	x	x	x	x
3. Defective material or workmanship	2/	x 2/		x	
4. Defective design	2/	x 3/			

1/ This period could be reduced in the event that insurers are satisfied at any earlier date.

2/ Defective material or workmanship and defective design are excluded from the Erection All Risks Policy; however this policy does cover resultant material damage arising from that defective design, material or workmanship. The effect of this is that a substantial amount of protection in this field is provided by existing insurance cover.

3/ The EAR Loss of Advance Profits (LAP) Policy extension which covers consequential losses prior to handover of a plant has, currently, a total exclusion of all losses arising from defective design. However insurers may be prepared to extend the cover to include the consequences of defective design (thereby providing similar cover to the EAR Policy) subject to their being totally satisfied that only time-tested designs and experienced contractors are involved.

SOURCE: Report of the Meeting of Experts of the Insurance of Consequential Losses Incurred by Fertilizer Plants, Vienna, 18-20 September 1978 (ID/WG.284/1)

37. The insurance experts suggested that a multilateral insurance scheme should be designed to cover the gaps listed under (a) and (b) but not (c); they suggested that losses due to some other specific causes of force majeure might be covered. At the same time, it was pointed out that gaps identified above are based on obtaining the widest covers available from individual insurance companies not necessarily operating on a world-wide basis.

38. There is an insurance cover available on a limited scale to the Pruchasers which in the event of the contractor's insolvency enables the Purchaser's to recover all damages to which he is entitled according to the contract. This Supplier's Default Policy covers the gap of non-completion of the works by the Contractor in the case of insolvency. Since this type of insurance is written by an insurance market which is different from the market covering the risks described in para.33 above, the insurance experts advised that it should be excluded from the coverage of the multilateral insurance scheme.

39. The insurance experts advised that the new type of insurance cover offered by the multilateral insurance scheme proposed in this paper should be designed to supplement the standard forms of insurance cover which are available at present (para.33). Evidence that such insurance covers have been obtained is likely to be an important pre-condition for obtaining the additional insurance required to cover the gaps mentioned above.

40. They also felt that the multilateral insurance scheme would clearly be easier to implement if the Purchaser took out all the insurance covers himself. The present practice as regards the division of responsibility between the Contractor and Purchaser is described in Article 24 of the Model Contracts.

41. The cost of the major existing insurance covers is estimated in the Table below. It amounts to $11.5 million over 3 years of construction and 3 years of operation, that is about 1 per cent per annum of the project cost.

TABLE V

Estimated Cost of Major Insurance Covers available at present

	During Construction of plant	During Operation of plant
Period covered by insurance policy	3 years	1 year
Cost of insurance policy		
Erection/Contractors All Risks	1.4	-
EAR Consequential Loss 1/	0.6	-
Fire and Allied Perils (completed plant)	-	1.7
Fire and Allied Perils Consequential Loss 1/	-	0.5
Machinery Breakdown (completed plant)	-	0.9
Machinery Breakdown Consequential Loss 1/	-	0.4
	2.0	3.5

Source: A firm of Lloyds Brokers,1977. UNIDO has been informed that the of insurance in 1980 would possibly not be higher than in 1977 and might be lower.

Note : Estimates are for an ammonia/urea complex costing US$200 million; indemnity for consequential loss was assumed to be at a rate of $47 million per annum.

1/ Maximum loss covered would be loss of 12 months' production.

42. The discussions with insurers of the risks borne by the Purchaser and the Contractor and the extent to which they can be covered by commercial insurance at present helped UNIDO to define the multilateral insurance scheme proposed in the next Chapter.

CHAPTER VI

THE MULTILATERAL INSURANCE SCHEME PROPOSED BY UNIDO

The Approach adopted

42. When UNIDO invited a group of experts to help draft a multilateral insurance scheme ,they advised the UNIDO secretariat that the insurance scheme would have to apply to all types of industrial plant and not solely to fertilizer plants. This would enable insurers to obtain a wider "spread-of-risk" which is a critical aspect of insurance underwriting.

43. The experts recognized that the Purchasers of industrial plants have some financial protection by way of performance bonds or guarantees, product warantees and liquidated damages under the contracts, but that no contractual protection exists for consequential losses. Insurance policies have been developed which provide protection for such losses resulting from material damage or mechanical breakdown. No insurance is currently available where there has been no such damage or breakdown[1/].

44. The experts decided to draft a draft insurance policy which would provide supplementary cover to currently available policies. The draft insurance policy is designed to provide adequate compensation in respect of consequential losses incurred by the Purchaser due to the late completion or the non-performance of an industrial plant and resulting from inadequacies in the work performed by the Contractor, his sub-contractors, suppliers or manufacturers. In addition, an attempt is made to provide similar compensation to the Purchaser should the progress of the project construction be frustrated by an otherwise uninsurable incident of Force Majeure.

1/ The Contractor and Supplier can obtain more complete insurance cover than the Purchaser who usually suffers far greater consequential losses. The Contractor can obtain Professional Indemnity Insurance and the Supplier of equipment can insure his liability under the warrantees he provides.

45. Since these are considered as enormous additional risks by the insurance industry, the next step is to test the willingness of insurers to cover the risks. The UNIDO secretariat has authorized an international insurance consultant[1/] to test this draft insurance policy in the world insurance and re-insurance markets as to its acceptability, viability and potential c t and also to the potential insurance capacity available. He is working in a neutral and independent capacity.

46. By the end of August 1980, the UNIDO secretariat expects to be advised as to whether sufficient support is likely to be forthcoming from the private insurance sector to enable the proposed multilateral insurance scheme to be viable or not.

47. In the event a substantial positive response is duly received from the major insurers and re-insurers approached, ways and means of involving national insurance companies of developing countries will be examined.

The Concept and Principles of the Insurance Policy suggested

48. The suggested insurance policy prepared for UNIDO would protect the Purchaser in the event of:

A) A delay or delays in the completion of the Plant during the Policy Period

- or -

B) The failure of the completed Plant to fully perform in accordance with contract specifications and technical data during the Policy Period, caused by or resulting from:

- faulty engineering and application of process.
- faulty project or construction management or technical assistance.
- faulty manufacture, installation, erection, construction repair or rectification.
- faulty workmanship or materials.

All undertaken or provided by and within the control of the Contractor(s) appearing in the Policy Schedule or his Sub-Contractors, Suppliers or Manufacturers.

- an incident of Force Majeure as particularly defined and specified in the said Contract(s).

1/ Mr. A.James Edwards, Senior Vice President-International, Reed Stenhouse Limited, Toronto, Canada.

49. Compensation under the suggested policy would be paid on a daily amount basis agreed in advance between the Purchaser and the Insurer. The Purchaser would determine the appropriate amount required to compensate for the loss of production, interest charges on capital employed and certain other losses. The daily indemnity would be paid for a specified period of time depending upon the project in question and the Purchaser's requirements. There would be a reasonable waiting period before daily indemnity payments started to allow the insurers to investigate and determine the cause of the loss.

50. The suggested policy would cover the construction period plus the first three years of commercial operation.

51. The Purchaser would still remain exposed to some commercial risks, in particular those risks that are within his control or that of his national authorities. The suggested policy would not cover losses resulting from the financial failure of the supplier for which cover might be obtainable under a Supplier Default Consequential Loss insurance policy, for which a limited insurance market already exists (see para. 38 above).

52. The Purchaser would be required to ensure that other general, marine, construction and operating insurance covers are obtained and maintained in force to cover material damage and consequential loss. The other insurance covers described in the suggested Policy are those listed in para. 33.

53. Prior to the issue of a policy, a comprehensive Risk Analysis of the project would be undertaken on behalf of the insurers, jointly with the Purchaser. Thus the Purchaser would obtain an independent analysis of the financial risks he will face under the contract.

54. Having requested this insurance cover, the obligations of the Purchaser would be:

(a) To supply to the Insurer a copy of the Contract for construction of his plant and to contribute, when requested, to the completion of the Risk Analysis;

(b) To supply to the Insurer a copy of the warrantees and performance guarantees obtained from or by the Contractor;

(c) To obtain necessary performance bond(s) or financial guarantee(s) and to recover amounts under such instruments where the bonded party fails to fully perform in accordance with the relevant contract;

(d) To pay the consequential loss insurance premium promptly to enable the insurance to be activated and maintained;

(e) To pursue the completion of the project in accordance with the contract and with all due diligence and dispatch.

(f) To permit the insurer, or their representatives, to make such site inspections and enquiries as they may decide;

(g) To promptly report any incidents or events which may give rise to a claim under the policy and to take any remedial action requested by the Insurers;

(h) To pursue all remedial rights under the contract to obtain remedies or reimbursement from the Supplier or others;

(i) To assist the Insurer, as may be required, in pursuing their subrogation rights against any non-insured party.

55. The obligations of the Insurer would be as follows:

(a) To study the Contract for construction of the Plant and obtain a comprehensive Risk Analysis of the project;

(b) To study such Risk Analysis, prepare the insurance quotations and issue the relevant policy when requested;

(c) To satisfy themselves on the extent and stability of other general project construction and operational insurance covers which the Purchaser is obliged to obtain and maintain (paras. 52 and 33 above);

(d) To make such site inspection and investigation as they may require and to monitor the progress of the work and the subsequent operation of the plant;

(e) To take whatever immediate action has to be taken following reporting of potential claims by the insured Buyer;

(f) To advise the insured Purchaser of any actions they require the Buyer to take either during construction or operation of the plant and, in particular, following any reported potential claims;

(g) To assess and adjust valid claims in accordance with normal adjusting practices either by using their own specialist claims personnel or professional loss adjustors;

(h) To promptly settle valid claims following completion of the necessary Proof of Loss documentation.

Advantages of the Insurance Policy suggested

56. At the Second Consultation on the Fertilizer Industry, participants from the developing countries saw a need for the multilateral insurance scheme because the failure of fertilizer plants had a serious effect on fertilizer supplies and the balance of payments of their countries. The insurance policy suggested would provide additional compensation in the event of such failure, thus enabling the country to maintain fertilizer supplies and the enterprise to avoid serious financial difficulties.

57. The UNIDO Secretariat suggests that the multilateral insurance scheme would have a number of other distinct advantages, not only for the Purchaser, but also for the Contractor and the parties involved in financing the plant. These advantages are as follows:

(a) The entire project is protected against major financial risks not previously covered by either the contract or insurance;

(b) The insurer helps guarantee completion of the plant and to maintain sales turnover of the enterprise in the interim period;

(c) As a result of the above, the buyer should obtain financing for his project more easily and on better terms and conditions;

(d) Through the Risk Analysis, the Purchaser obtains an independent assessment of the financial risks of his project and the contract conditions;

(e) The Purchaser has the possibility of obtaining independent engineering advice from the Insurer throughout the period covered by the policy.

58. There are other advantages for the country in which the insured project is established. The national financing agencies have additional protection for their project financing. The national insurance companies may have the opportunity to participate in a new form of insurance cover offered to all types of industrial plant.

59. The Inter-American Development Bank has expressed interest in the proposed scheme and has begun to co-operate with UNIDO in analysing the amount and causes of consequential loss incurred by industrial projects in the other industries , as well as the fertilizer industry. UNIDO expects other international financing agencies to extend similar co-operation.

CHAPTER VII

CONCLUSIONS

60. Part III of the Paper explained why Governments could not be expected to support a multilateral insurance scheme without a major change in policy supported by legislation. Therefore, in order to introduce a third party which could manage the scheme and act as arbitrator, the multilateral insurance scheme proposed by UNIDO has been designed so that it might attract the interest and support of the world commercial insurance market. The cover which the insurance industry might offer on the basis of a draft insurance policy prepared by UNIDO is in the process of being assessed and will be reported to the Consultation.

61. The multilateral insurance scheme will cover large new risks and the cost of the premium for the additional covers offered by the suggested draft policy cannot be estimated at this time. The premium will be in addition to the premiums which the Purchaser usually has to pay directly or indirectly for the following insurance covers:

(a) Existing insurance covers that are a pre-condition for obtaining the additional insurance cover as listed in paragraph 33 above; the cost is estimated in paragraph 41;

(b) For guaranteeing repayments by the Purchaser if the plant is purchased with export credit;

(c) For insuring against the unfair calling of a bond if the Contractor provides a performance bond and insure it;

62. It should not be forgotten that the premiums charged for the multilateral insurance scheme when implemented with the world commercial insurance market will in total need on the average to cover the expected losses. This means that if the Purchasers in developing countries pay the insurance premiums themselves, they will, as a group, be financing the guarantees of performance which the Contractor is not willing to assume himself.

63. Bearing in mind the above discussion and the advantages the insurance scheme for both the Contractor and his Government (paragraphs 21 and 57), the Consultation is invited to suggest any modifications required to bring the insurance scheme in line with the original request mentioned above in paragraph 2, which asked Governments of developed countries to establish the insurance scheme.

ANNEX A

MEMBER OF BERNE UNION'S EXPORT INSURANCE COMMITTEE

The members of the EIC are:

ARGENTINA	Compañía Argentina de Seguros de Crédito a la Exportación S.A.	(CASC)
AUSTRALIA	Export Finance and Insurance Corporation	(EFIC)
AUSTRIA	Österreichische Kontrollbank A.G.	(OKB)
BELGIUM	Office National du Ducroire	(OND)
CANADA	Export Development Corporation	(EDC)
DENMARK	Iksportkreditrodet	(EKR)
FINLAND	Vientitakuulaitos	(VTL)
FRANCE	Compagnie Française d'Assurance pour le Commerce Extérieur	(COFACE)
	Société Française d'Assurance pour Favoriser le Crédit	(SFAFC)
FEDERAL REPUBLIC OF GERMANY	Hermes Kreditversicherungs - A.G.	(HERMES)
HONG KONG	Hong Kong Export Credit Insurance Corporation	(HKEC)
INDIA	Export Credit and Guarantee Corporation Limited	(ECGC)
ISRAEL	The Israel Foreign Trade Risks Insurance Corporation Limited	(IFTRIC)
ITALY	Sezione Speciale per l'Assicurazione dei Credito all'Esportazione	(SACE)
	Società Italiana Assicurazione Crediti	(SIAC)
JAPAN	Export Insurance Division Ministry of International Trade and Industry	(EID/MITI)
REPUBLIC OF KOREA	The Export-Import Bank of Korea	(EIBK)

MEXICO	Fondo para el Fomento de las Exportaciones de Productos Manufacturados, Banco de Mexico	(FOMEX)
NETHERLANDS	Nederlandsche Credietverzekering Maatschappij N.V.	(NCM)
NEW ZEALAND	Export Guarantee Office	(EXGO)
NORWAY	Garanti-Instituttet for Eksportkreditt	(GIEK)
PAKISTAN	Pakistan Insurance Corporation	(PIC)
PORTUGAL	Companhia de Seguro de Créditos E.P.	(COSEC)
SINGAPORE	Export Credit Insurance Corporation of Singapore Limited	(ECICS)
SOUTH AFRICA	Credit Guarantee Insurance Corporation of Africa Limited	(CGIC)
SPAIN	Compañía Española de Seguros de Crédito a la Exportación S.A.	(CESCE)
	Compañía Española de Seguros de Crédito y Caución S.A.	(CESCC)
SWEDEN	Exportkreditnänmden	(EKN)
SWITZERLAND	Geschäftsstelle für die Exportrisikogarantie	(GERG)
	The Federal Insurance Company Limited	(FEDERAL)
UNITED KINGDOM	Export Credits Guarantee Department	(ECGD)
	Trade Indemnity Company Limited	(TIC)
UNITED STATES	Export-Import Bank of the United States	(EXIMBANK)
	Foreign Credit Insurance Association	(FCIA)