

Liquidation of Iraq Airways

Dr. Kamal Field Al-basri
Iraq Institute for Economic Reform
kamal@field.net

27-05-2010

Introduction

The Iraqi Council of Ministers has announced that it will be ordering the dissolution of Iraqi Airways and the sale of all its assets, specifically Iraqi Airways airplane fleet. The decision to close down Iraqi Airways was formed as a result of Kuwait seeking compensation for stolen aircraft in the Iraqi invasion of Kuwait in 1990, and has subsequently sought to cripple Iraqi Airways operations until damages have been paid. The decision by Kuwait to chase Iraqi Airways for the damages in many of its countries of operation has forced the Council of Ministers to take this decision.

History

During the 1990 Iraqi invasion of Kuwait, the occupying Iraqi military seized 10 Kuwaiti owned airplanes, worth a reported US\$1.2 billion and flew them to Iraq. The Revolutionary Command Council of Iraq adopted a resolution dissolving Kuwait Airways and transferring all its property worldwide, including the ten airplanes, to the state-owned Iraqi Airways. This resolution, known as resolution 369, came into force on 17 September 1990. On the same day the Iraqi Airways board passed resolutions implementing resolution 369.

The sanctions and air restrictions placed by the United Nations (UN) following the first Gulf war meant that Iraqi Airways could only use helicopters for limited domestic services and was unable to use its own, or the seized fixed-wing planes until its reformation after the coalition invasion of Iraq in 2003.

The removal of UN sanctions and air restrictions meant that in 2004, Iraqi Airways was given the go-ahead to recommence air transport services. This began first by allowing the airline to resume domestic flights and subsequently, international flights to service Iraq's aviation needs. However, also in 2004, Kuwait Airways obtained a British High Court order that gave the authority for the seizure of any Iraqi Airways plane that landed in the United Kingdom until the US\$1.2 billion in damages were paid.

The reason the British High Court was used and not the United Nations Compensation Committee, which was set up to determine compensation for losses arising from the 1990 invasion of Kuwait, was because this was a direct dispute between Kuwait Airways and Iraq Airways. The British legal system allows for international disputes to be brought before it.

Kuwait Airways tried to file similar lawsuits in other countries, the most notable being Kuwait's attempt to seize 10 new Canadian-made Bombardier airplanes ordered by the Iraqi government. Canadian courts ruled against Kuwait Airways and stipulated that it did not have the power to seize the planes as they had been ordered by the national government of Iraq not by Iraqi Airways itself.

The previous Iraqi regime had admitted that 10 planes were seized by them during the invasion of Kuwait and subsequently returned 6 of the aircraft via Iran, the condition of which has not been reported, before the first Gulf war commenced. Iran returned the planes to Kuwait in 1992 but they were never flown again. The remaining 4 were reportedly destroyed in a bombing raid on Mosul Airport during the first Gulf war.

Legal Implications

As a result of the British High Court ruling, Iraqi Airways maiden voyage to Britain on 30th of April ended bitterly, with lawyers representing Kuwait Airways in the legal dispute issuing the seizure order as the plane landed in London. This resulted in the impounding of the Iraqi Airways airplane, which was leased at the time from a Swedish charter company, and the seizure of the Captain and Director-General of Iraqi Airways, Kifah Hassan's passport. He was ordered to remain in the UK pending a high court hearing. Iraqi officials are said to have been dismayed at his detention in the UK.

Mr Hassan was held in the UK until the 6th of May where he was allowed to return to Iraq on the condition of disclosing Iraqi Airways assets and holdings and to return to the UK for cross-examination.

So what did the Legal ruling mean for Iraqi Airways? In short, it meant that Iraqi Airways could not operate freely until its debts were cleared. With a fleet of only 13 planes, 1 of which is used exclusively by Iraqi Government officials, Iraqi Airways, nor the Iraqi Government, would be able to afford the US\$1.2 billion in damages. The court ruling would also mean that it would not be able to operate in vital countries such as the UK, the hub of international flights.

Given the vast amount of debt over its head, the only viable option for Iraqi Airways is to dissolve itself and with it, the debt that it directly owes Kuwait Airways. This is a quick solution for Iraq Airways. It could be possible that Kuwait Airways may seek compensation directly from the Iraqi Government or for it to secure a fraction of the compensatory payments made by Iraq to Kuwait for the damages caused by the invasion of Kuwait.

It is important to note that the legal ramifications of the dissolution of Iraqi Airways have yet to be unearthed, and the extent to which the Iraqi Government, and in particular, the Ministry of Finance who would take charge of any funds raised from the dissolution, would be liable to future attempts to recover damages. The legal implications for Kuwait Airways of Iraqi Airways dissolution are for them to discover.

Liquidation of assets.

Following the dissolution of Iraqi Airways, the biggest problem they will face is what to do with capital assets, namely the airlines fleet. Iraqi Airways has already reported that it will maintain the employment of its entire staff until a solution has been drawn.

There are three viable solutions for airlines fleet, but all are contingent on the condition of transparency. It is also important to note the aviation industry has suffered tremendously over the last 3 years as a result of the world financial crisis. The bankruptcy of large airlines will have invariably depressed used airplane prices and the further sale of any planes will depress the prices further.

Any of the solutions provided will result in Iraqi Airways suffering losses on the book value of the planes, but it is important to note that these losses will be lower than the compensation value to Kuwait Airways, or the opportunity cost of loss of earning from not being able to fly to important countries such as the UK.

The first solution is for an auction of the entire fleet. The benefit of an auction is its transparent nature and its efficiency of quick sales. It will allow Iraqi Airways to liquidate its assets in a swift manner with minimal effort.

The second solution is for the planes to be valued independently and then put on the market for a slow-time sale. Iraqi Airways would have to wait as rival airlines or private buyers make offers for the airplanes.

The third solution is for Iraqi Airways to sell all of its fleet to a holding company. The holding company will maintain ownership of the fleet pending the formation of a new private national airline that will then purchase the fleet from the holding company at cost so as to ensure that transaction costs are kept to a minimum.

International Support

The dissolution of an airline is not an easy deed to accomplish. The complexities of valuation and the sale of the airplanes could potentially result in Iraqi Airways selling at the wrong price, and making avoidable losses. The benefits of appointing consultants to advise Iraqi Airways during this process are exponential for many reasons.

The first and most obvious reason is experience. By hiring consultants that have experience in the sale of aircraft, Iraqi Airways will be able to take advantage of their knowledge and try to get the best deal possible for their fleet. A consultancy firm that understands the aviation industry and has dealt with similar dissolutions will have a unique advantage over the airline trying to go it alone.

The second advantage is that of transparency. By taking the potentially corruptible decisions out of the hands of politicians and unaccountable company

directors, it ensures that the best value for money is gained when the aircraft are sold.

A new private airline.

With the legal wrangling faced by the state-owned Iraqi Airways, the only solution for a future Iraq based airline is for private companies to be formed that provide the efficiency through competition and extensive service by covering the major domestic and international routes. The Ministry of Transport should auction off licenses to operate domestic flights in Iraq to both existing and start-up airlines which they can compete for. It should also auction off international landing slots under the same conditions.

The advantage to this approach is that it raises revenue for the government, which should be ideally reinvested in air transportation. The other advantage is that it will maintain competition of between firm operating in Iraq and will ensure that Iraq's air transportation needs are met.

Although the current transformation of Iraqi Airways is not that of conventional privatisation, given the actual dissolution of the airline, many lessons can be drawn from previous privatisation of airlines in the formation of a new Iraqi Airline.

The privatisation of airlines has had many success stories in the past, the most comparable being that of Kenya Airways in 1995. The International Finance Corporation, which is part of The World Bank, advised the Kenyan Government on how to privatise the airline. By selling a 26% share to KLM Royal Dutch Airlines and further 51% to various private investors, the airline was able to increase flight capacity by 61% and since its privatisation, has been profitable ever since.

The 26% sale of Kenya Airways to KLM Royal Dutch Airlines facilitated the transfer of US\$70 million to the Kenyan Treasury; a lucrative proposition by any standards. Because of the privatisation, Kenya Airways also received a US\$15 million loan from the IFC to modernize its current fleet of airplanes.

Iraq can learn from this model, and it is important for it to do so. It will now have to start a new airline from scratch. The provision of staff and planes is not too great an issue as many of them can be effectively transferred over to the new airline from Iraqi Airways. A problem however, will be the need for efficiency savings given the fragile nature of a new start-up.

By offering a portion of the new start-up (with capital assets on its books) for sale to a reputable, experienced airline, the new Iraqi Airline can benefit in two ways. The first is the knowledge and experience the stakeholder airline can provide in terms of how best to operate the new airline. Although there may be members of staff who are experienced that transfer over from Iraqi Airways, they will not have the knowledge or exposure that a worldwide airline company

can offer, especially given the patchy level of service over the last 6 years, and the complete lack of operation after the first Gulf war.

The second benefit is that the financial liquidity that will be provided to the airline, by the sale of equity in the company, will help it in many ways. Financial liquidity can support the airline through its short-term losses, especially as a new start-up airline. The financial liquidity from equity sales can also provide financing for capital investment to expand operations and to get onto important routes for the airline.

The Future

Iraq has the geographical advantage by bordering 6 countries and it is a natural hub to service the Middle-Eastern aviation needs. Although this is currently being provided by Dubai, Iraq can provide healthy competition in region. There is a strong demand for religious tourism and with the continuous improvement in national security, leisure based tourism as well. With a large worldwide expatriate community that seeks regular visits to Iraq, the demand of which will improve if a new Iraqi airline covers vital routes to Europe and North America.

There is no doubt that the potential for success of an Iraqi airline is great, however, the most important step now is to ensure efficiency and value for money. Iraqi Airways must ensure that it liquidates its fleet in a manner that is both transparent and efficient to ensure that public finances do not suffer at the hands of private gain. Any decision that is made should be to ensure that the needs of the Iraqis are met in the best way possible.