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Monthly Digital Publication by
ABOGADOS SIERRA

How the Russia- Ukraine conflict is impacting the aviation insurance and other aspects on leasing.

- By Vera García



SEPTEMBER NEWS ON MEXICAN AVIATION

PRONUNCIATION:
'che-l&m is Latin for airspace or sky. The Romans began questioning the rights they had in the space above the land they owned and how high above them those rights would extend. They decided on, Ad coelum et ad inferos, meaning that their property rights would extend as high up as the heavens and all the way down to hell.

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October 15, 2022
Year 17 No. 05

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Audio Message

How the Russia- Ukraine conflict is impacting the aviation insurance and other aspects on leasing.

by Vera García

As you all know on February 24, 2022, Russia invaded Ukraine causing a series of actions by the European Union[1], the United Kingdom, the United States of America and number of other governments around the world, including sanctions in the aviation sector that restrict the ability of Russian air carriers to perform their aircraft lease and/or finance obligations, such as making payments, providing insurance coverage; maintaining a valid certificate of airworthiness, maintaining registration on a designated aircraft registry, and performing maintenance tasks required to ensure airworthiness[2].

Russia responded by closing off its airspace to carriers of 36 countries, ordering Russian operators to return all aircraft held under agreements to the territory of Russia; requesting certain states not to take action impeding such return; requiring the approval of a special commission for the redelivery of an aircraft to a creditor; directing Russian operators to operate and maintain the aircraft in accordance with the airworthiness standards of the Russian Federation; entitling Russian operators, without the consent of the creditor, to place aircraft on the registry maintained by the Russian Federation; and unilaterally modifying the agreements to override and replace terms that *(i) constitute contractual defaults and termination events, (ii) require payment in US Dollars or another foreign currency, (iii) require aircraft registration in a jurisdiction other than the Russian Federation, (iv) require maintenance of an airworthiness certificate issued by an airworthiness authority other than the Russian Federation, and (v) require insurance underwritten by markets outside of the Russian Federation*[3].

As shared in a previous edition of Coelum, under such circumstances, the operation of any Russian registered aircraft after February 25, 2022, imply an Event of Default under the corresponding lease agreements, consequently, lessors terminated Russian operators' rights to poses and use the aircraft and demanded repossession and control of such aircraft.

There were some successful repossessions of foreign owned aircraft outside of Russia[4]. However, industry estimates state that approximately 400 foreign-owned aircraft remain in Russia[5], it remains unclear how and when foreign owned aircraft and parts trapped in Russia can be repossessed. Even if Russian airlines want to cooperate with foreign owners or financing parties seeking repossession, the obstacles put in place by the Russian authorities combined with the sanctions implemented by the EU, UK and US, make recovery of aircraft located in Russia extremely difficult.

Monitoring

As can be seen, international businesses face tremendous risk from foreign government political actions, events, and conditions; therefore, the former intend to monitor political risk though specialized organizations. In the aviation industry, the Aviation Working Group (AWG), for instance assigns a score and a categorization of the contracting states to the Cape Town Convention related to their compliance to the Cape Town Convention and

1.-Article 3c of Regulation 2022/328 adopted by the European Union on February 25, 2022, which took effect on February 26, 2022
2.- Russia -- Ukraine: AWG Statement on CTC Convention Provisions Material to Creditors with respect to Aircraft Possessed by Russian Carriers and Located Within the Territory of the Russian Federation (8 March 2022) http://awg.aero/wp-content/uploads/2022/03/Russia-Ukraine-AWG-Statement-Regarding-CTC-Aircraft-Within-the Territory-of-Russian-Federation-2022-3-8.pdf
3.- AWG Statement on Russian State Action Constituting Breach of the Cape Town Convention Release Date (18 March 2022) http://awg.aero/wp-content/uploads/2022/03/AWG-Statement-Russian-State-Action-Constituting-CTC-Breach-March-18-2022.pdf
4.- Foreign Registered Aircraft Grounding: A Matter of Timing and Precision, (15 April, 2022) COELUM by Misael Arellano.
5.- Russia holding 400 passenger jets hostage in global sanctions fight, Washington Post (July 12, 2012) by Eanne Whalen, Ellen Nakashima and Hafeel Faris https://www.washingtonpost.com/business/2022/07/12/russia-aircraft-seizure-sri-lanka/

its Aircraft Protocol (CTC). The score is based on whether the CTC is fully and effectively implemented, prevails over conflicting law, and is being interpreted and applied in accordance with its terms and intent. The AWG uses the methodology found on the Cape Town Convention Index[6].

As a result of the crisis, Russia and Ukraine's scores have been removed from the Cape Town Convention index, and a special notice has been put up, as there is *"no predictive value for future compliance by Russia"* the same was said about Ukraine[7].

Insurance

Any aircraft operated under a lease agreement is covered by the lessee insurance. *Russian law requires that Russian air carriers arrange for all such primary insurance coverage to be issued by domestic Russian insurers under Russian law-governed insurance policies[8].* The coverage required under the lease agreements will typically include:

- Hull all Risk - covers loss or damage to an aircraft while flying or on the ground for an agreed value.
- Hull War and Allied Perils Risks - covering such risks fully excluded from the Hull All Risks Policy available (including confiscation and requisition by the government of the State of Registration) for the Agreed Value.
- Liability insurance coverage - covers general third-party liability of the airline, including indemnity obligations it may have as lessee under its leases.

Such insurance certificates usually incorporate the requirement that any payment under the Hull All Risks and Hull War Risks policies that relates to a total loss of an aircraft be paid directly to the Lessor, Financier or Owner of the Aircraft.

Furthermore, usually lessors and financing parties contractually require lessee to have their insurance reinsured in the international aviation insurance markets. As well as the insurance policies, the reinsurance certificate may include an express cut-through clause pursuant to which the reinsurers agree to pay the reinsurance proceeds directly to the owner, lessor, and financier rather than the reinsured.

It is important to note that in response to the sanctions, as of March 14, 2022, *the reinsurance rules in Russia were amended to prohibit Russian insurance companies from reinsuring their risks with reinsurance companies registered in the so-called "unfriendly states" unless a special permit is obtained from the Central Bank of Russia[9].*

Claim

Insurance claims may be available to a foreign owner, lessor and financier of an aircraft trapped in Russia. However, this could vary case by case depending on the specific facts of the case and the specific insurance covering the aircraft. In fact, certain lessors have already submitted insurance claim, in relation to aircraft and engines remaining in Russia[10].

To make a claim against reinsurers for a total loss of an aircraft, Lessors, owners, and financiers should prove that a total loss of the aircraft has occurred. Claims would likely be based or are based on total loss resulting

6.- Cape Town Convention Compliance Index, Aviation Working Group, Methodology (April 2020)
7.- Cape Town Convention Index https://ctc-compliance-index.awg.aero/
8.- https://beinsure.com/lessons-for-insurance-industry-after-russias-seizure-aircrafts/#claims-against-reinsurers-and-reinsurers-defenses
9.- https://beinsure.com/lessons-for-insurance-industry-after-russias-seizure-aircrafts/#claims-against-reinsurers-and-reinsurers-defenses
10.- Washington Post (updated 12 July, 2022) Russia holding 400 passenger jets hostage in global sanctions fight by Eanne Whalen, Ellen Nakashima and Hafeel Faris https://www.washingtonpost.com/business/2022/07/12/russia-aircraft-seizure-sri-lanka/

from theft or confiscation, nationalization, seizure, detention, or requisition of title to or use of an aircraft by the Russian government. Nevertheless, even if owners, lessors, and financing parties can prove that a total loss of the aircraft has occurred, reinsurers may have a defense against paying claims as a result of the termination of the reinsurance policies[11].

Nothing has yet been settled or said and the reinsurance companies have yet to issue a statement on whether they will pay or are legally disabled to pay the reinsurance claims to non-Russian owners, lessors, and financiers.

> ***"... it can be said that aviation insurance terms and specific clauses will significantly change in the future. Furthermore, and as consequence of this crisis, the insurance rates will also substantially increase, thus increasing the total price of the transactions."***

Future of the aviation transactions

The mutual sanctions and air restrictions have heavily affected the aviation sector, causing among others, the cancellation, or rerouting of flights, increased air ticket prices, higher fuel costs and extraordinary financial losses for lessors, owners, and financiers who have assets leased into Russia[12].

Lessors, owners, and financiers *have accepted the fact that most aircraft and aircraft parts they have placed within Russia will not be repossessed* and if they ever recover their aircraft, they won't be able to use them because they won't be able to verify their air worthiness[13].

The Russian actions in Ukraine are likely to have a significant impact on the future of aviation transactions. This crisis "showed us" that risk of expropriation, or government seizure of property; regulatory restrictions; currency and exchange controls, risk of war and contract breaches by government is not as unlikely or improbable as we may have thought at some point.

The aviation industry players are in the midst of understanding political risk better and reassessing the framework for it. At this stage, it is impossible to foresee what would change in the aviation transactions or what would be the outcome of the insurance claims filed by lessors, owners and financiers who have suffered total losses in respect to the aircraft and aircraft parts located in Russia. However, it can be said that aviation insurance terms and specific clauses will probably significantly change in the future. Furthermore, and as consequence of this crisis, the insurance rates will also substantially increase, thus increasing the total price of the transactions.

11.-AVN 111(R) (Sanctions and Embargo Clause) provides that "if, by virtue of any law or regulation which is applicable to a Reinsurer at the inception of this Policy or becomes applicable at any time thereafter, providing coverage to the Reinsured is or would be unlawful because it breaches an embargo or sanction, that Reinsurer shall provide no coverage and have no liability whatsoever" https://beinsure.com/lessons-for-insurance-industry-after-russias-seizure-aircrafts/#claims-against-reinsurers-and-reinsurers-defenses

12.- The impact of the war in Ukraine on the aviation industry (25 March, 2022) IATA Economics. https://www.iata.org/en/iata-repository/publications/economic-reports/the-impact-of-the-conflict-between-russia-and-ukraine-on-aviation/

13.- Washington Post (updated on 12 July 2022) Russia holding 400 passenger jets hostage in global sanctions fight by Eanne Whalen, Ellen Nakashima and Hafeel Faris https://www.washingtonpost.com/business/2022/07/12/russia-aircraft-seizure-sri-lanka/

Ministry of the Navy prevented the entry of 73 foreigners daily to Mexico since it took control of the Mexico City Airport due to failures.

In February of this year, the Ministry of the Navy (SEMAR) took control of the Mexico City International Airport (AICM) and until June has prevented approximately 8,8800 foreigners from entering Mexico as a result of irregularities in their documentation. Additionally, it has granted 80 humanitarian aids, medical attention to 417 people, 102 arrests, and seized over $430,000 USD, 213,000 euros, 179,000 Chilean pesos, 4 weapons, and 155.3 kilograms of drugs. Furthermore, the President of Mexico instructed, through a reform approved by Congress, to administer and provide security in the country's ports in efforts to limit the illicit trafficking of weapons, ammunition, explosive, money, drugs, and hydrocarbons that try to enter the country illegally with efforts to avoid corruption. *www.eleconomista.com.mx/politica/Semar-impidio-el-ingreso-diario-de-73-extranjeros-a-Mexico-desde-que-tomo-control-del-AICM-por-fallas-20220905-0099.html* September 05, 2022.

AFAC bets on salary and vacancy increases to recover Category 1.

The 2023 Federal Expenditure Budget Bill (PPEF) contemplates an increase in salaries and benefits for workers of the Federal Civil Aviation Agency (AFAC) and Mexican Airspace Navigation Services (SENEAM), in addition to more positions and new technical and inspector positions, among others. The adjustments are relevant at the time of regaining Category 1 status in the International Aviation Safety Assessment Program (IASA), as there are at least three findings in the FAA audit related to the low level of salaries and lack of personnel. "It [the budget] is still pending approval, but it would be ideal because they would have higher salaries, it would facilitate hiring, and they would have conditions to complement the reasons why they were downgraded," refers Fernando Gómez Suárez, air sector analyst. *www.expansion.mx/empresas/2022/09/22/afac-seneam-incrementos-salarios-plazas-categoria-1-faa* September 22, 2022.

Felipe Ángeles International Airport (AIFA) will double air passenger capacity by 2023.

Mexico's Felipe Ángeles International Airport (AIFA) is trying to regain its Category 1 in airspace security by increasing passenger flights from said airport. The master plan is collaboration with airlines in the United States of America to develop new routes to cities such as Chicago, Los Angeles, Houston, and various cities in Florida. The expansion of said plan will be addressed with moderate speed in order to abide by the airport's operations "soft or gradual opening" to remain in accordance with the development of air operations. *www.mexicobusiness.news/aerospace/news/aifa-will-double-air-passenger-capacit y-2023* September 26, 2022.

COFECE suspends ruling on aviation fuels.

The Federal Antitrust Commission (COFECE) mentioned that it has the necessary commissioners, so the deadline for the resolution of the procedure on jet fuel should be suspended. Such suspension is due to the lack of appointments of commissioners, and it was explained that for COFECE to exercise its mandate fully and properly, the Executive Branch must make the nominations it has received, but with the omission of the Executive Branch, COFECE filed a constitutional controversy proposing before the Senate the persons who would occupy such positions. *www.a21.com.mx/normatividad/2022/09/27/suspende-cofece-resolucion-sobre-combustibles-para-aeronaves* September 27, 2022.

Army airline would operate with 10 aircraft next year: AMLO.

The Federal Antitrust Commission (COFECE) mentioned that it has the necessary commissioners, so the deadline for the resolution AMLO confirmed the potential introduction of a new airline operated by the Mexican Army in 2023. The Mexican president made this decision based on the high demand for air services in the country. Information on the topic was brought to light by the mass leak of documents conducted by the hacker group ´Guacamaya´, which leaked numerous confidential official papers from the offices of the National Defense Agency (SEDENA). The new airline will operate under the Olmeca, Maya Mexica company, operated by the Mexican Armed Forces and also responsible for overseeing the construction of the Tulum Airport, the Felipe Angeles Airport (AIFA) and the Mayan Train. According to the Federal Chief Executive, the airline will operate with leased aircraft except for the presidential plane, which will also form part of its fleet. The Mexican Army is also considering its potential involvement in the creation of a new touristic company, which will administrate three hotels, two museums and two ecological parks. *www.www.forbes.com.mx/aerolinea-del-ejercito-operaria-con-10-aviones-el-proximo-ano-incluido-el-presidencial-amlo/* October 04, 2022.

In this month extract was prepared by P. Arandia, R. Nerio, J. García, A. Pérez, P. Nava, J. Mora, T. Martínez.

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VERA GARCIA

Attorney at Law: Admitted to practice law in 2012. Ms. Vera García, of Mexican nationality obtained her law degree at Tecnologico de Monterrey, México; holds master degree in Company Law by the Universidad Panamericana, México; attended post- grades studies in Corporate Law by Insituto Tecnológico Autonomo Mexicano; holds the Certificates of International Air Law; Airline Contract Law; Aircraft Acquisition and Financing; and Law of Aviation Insurance by the International Air Transport Association (IATA).

Languages: Spanish and English.

Practice Areas: Corporate and Aviation law.

e-mail: vgarcia@asyv.com

sierra
LATAM

Prol. Reforma No. 1190 25th Floor,
Santa Fe México D.F. 05349
t. (52.55) 52.92.78.14
f. (52.55) 52.92.78.06
www.asyv.com / www.asyv.aero

www.linkedin.com/company/asyv

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