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Political Risk and Contractual Protections in Aircraft Leasing.
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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.

Political Risk and Contractual Protections in Aircraft Leasing.

Vera García

A political event clause is a contractual provision intended to address circumstances outside the control of the parties that may affect the performance of an aircraft lease or financing transaction. These situations may include government actions, confiscation or detention of aircraft, sanctions, political instability, regulatory restrictions, or other circumstances that prevent or materially impair the parties' ability to exercise their contractual rights.[1]

The importance of this concept comes from historical events demonstrating that political circumstances can materially affect aircraft owners and financiers. The Iranian Revolution in 1979 was one of the first major examples of this type of risk. Following the change of government, aircraft operated by certain western carriers were grounded and effectively became unavailable to their owners. The aviation industry was not prepared for this type of exposure, either contractually or from an insurance perspective, which contributed to the development of Political Risk Insurance products.[2]

Similar concerns arose during the Gulf War in 1990-1991, when the Iraqi invasion of Kuwait resulted in the seizure of Kuwait Airways' fleet.[3] Later, the September 11 attacks significantly affected aviation insurance markets, as insurers withdrew certain war risk coverages from standard policies and governments temporarily intervened as insurers of last resort.[4] These events demonstrated that political risks could create significant losses that traditional lease protections were not always designed to address. As a result, Political Risk provisions and related insurance products became an increasingly relevant consideration in aircraft lease and finance transactions.

As geopolitical conditions became more stable over time, Political Risk clauses became less common in aircraft leasing practice. This changed after Russia prevented the return of hundreds of leased aircraft following international sanctions in 2022.[5] That situation highlighted the difficulties lessors may face when political events interfere with ownership rights and aircraft recovery.

More recently, political and institutional developments in certain jurisdictions have renewed attention to these issues. In Mexico, certain institutional, regulatory, and security-related developments have led some market participants to reconsider whether political event provisions or additional insurance protections should become more relevant in aircraft leasing and financing transactions.[6]

One possible approach is to incorporate a defined political event concept into existing contractual mechanisms, such as Material Adverse Change provisions. A political event occurring before closing could affect the parties' obligation to proceed with the transaction, while a political event occurring during the lease term could provide additional remedies if it materially affects the lessor's rights or the value of the aircraft.

The difficulty, however, is determining what should qualify as a political event. Not every political or regulatory development requires additional contractual protection. Certain events may already fall within traditional event of default provisions commonly found in aircraft leases and finance documents, such as insolvency, loss of required operating approvals, or sanctions directly imposed on the lessee. In those circumstances, the contractual consequences are generally clear, and additional political event protection may not be necessary.

The more difficult situations are those where political circumstances create significant risks for the lessor but do not prevent the lessee from continuing operations or making payments. Political risk is not limited to direct government actions. It may also involve institutional weakness, regulatory uncertainty, security concerns, or practical obstacles affecting the lessor's ability to enforce its rights or recover possession of the aircraft after termination of the lease.

For example, deterioration of the rule of law or practical obstacles to repossession may create serious concerns

1.- Example of a standard clause: "Political Event means the occurrence of any of the following events:
(a) the government or the executive head of state or equivalent Government Entity of Mexico is overthrown, deposed, or replaced by military force, coup d'état, rebellion, revolution, or insurrection (other than by democratic elections or democratic procedure); or (b) any suspension of the constitution (or equivalent primary instrument) in the Republic of Mexico; or (c) the incumbent government loses effective control over the territory, capital city, or critical state institutions reasonably required for effective governance in Mexico (such as any central bank or the military or judicial forces)."
2.- Bunker, Donald H. – International Aircraft Financing, Vol. I, Chapter 8, IATA, 2005
3.- Kuwait Airways Corporation v. Iraqi Airways Company, International Court of Justice, 1994 – icj-cij.org
4.- Parsons, John – "The Impact of September 11 on the Aviation Insurance Market", Journal of Air Law and Commerce, Vol. 68, 2003
5.- Impact of the Russian invasion of Ukraine on insurance markets (EN)
6.- Trump administration to target corruption in Mexico - Los Angeles Times

for a lessor even though no traditional event of default has occurred. This creates a negotiation challenge between lessors and lessees. Lessors seek protection against risks outside their control, while lessees may object to provisions that allow termination based on circumstances that are difficult to measure objectively. From the lessee's perspective, if the aircraft remains operational and rent continues to be paid, there may be an argument that no default has occurred.

"The foregoing protections are intended to address broader political or country risks that could materially affect a lessor's ability to enforce its rights."

Insurance is another important aspect of the analysis. In aircraft leasing transactions, lessors typically require lessees to maintain hull, passenger liability, third-party liability, and War Risks and Allied Perils coverage in accordance with AVN 52(D) or AVN 52(E).[7] By contrast, Political Risk Insurance and Aircraft Non-Repossession Insurance have historically been associated with higher-risk jurisdictions and are not commonly required in Mexican leasing transactions.

The foregoing protections are intended to address broader political or country risks that could materially affect a lessor's ability to enforce its rights. More recently, a limited number of lease agreements have included provisions under which the parties agree that the lessor may require repossession insurance, political risk insurance, or similar coverage, provided that such insurance is customarily available in the international aviation insurance market, on commercially reasonable terms and at commercially reasonable rates, and is reasonably required in light of the aircraft's jurisdiction of registration, habitual base, or intended operations.

Although these provisions provide a contractual basis for requesting Political Risk Insurance and Aircraft Non-Repossession Insurance, they do not grant the lessor absolute discretion. Rather, the lessor must still demonstrate that the coverage is customarily available in the international aviation insurance market, can be obtained on commercially reasonable terms and at commercially reasonable rates, and is reasonably required in light of the relevant jurisdiction or operations. While these standards leave room for commercial judgment, they also impose objective limitations on when such insurance may properly be required.

Accordingly, it would likely be difficult to justify requiring this type of insurance solely on the basis of regulatory uncertainty, delays in judicial proceedings, or isolated enforcement difficulties where no insured physical loss or comparable political event has occurred. Absent objective evidence of a material deterioration in the legal or political environment that significantly increases repossession risk, routine enforcement challenges would not ordinarily be expected to satisfy the contractual threshold.

Ultimately, contractual protection remains the primary mechanism for allocating repossession and political risks, while insurance should serve as a complementary risk mitigation tool. Well-drafted contractual protections should address extraordinary circumstances beyond the parties' control that materially impair the lessor's rights or ability to recover the aircraft, while avoiding language so broad that it becomes unclear which circumstances are intended to fall within the scope of the provision. Such protections should be based on objective criteria, including the nature, severity, duration, and actual impact of the relevant event.

Although Mexico does not presently appear to involve the type of imminent or systemic interference ordinarily associated with political risk or non-repossession claims, the broader issue remains relevant from an industry perspective. Even where current conditions do not justify these protections in a particular jurisdiction, it would be beneficial for the aviation industry to move toward a more consistent understanding of which specific circumstances should be treated as political risk, illegality, material adverse change, sanctions-related events, non-repossession risk, or traditional events of default, and how each of those circumstances should be addressed contractually. At present, the boundaries between these concepts are not always clear, and the analysis often remains highly subjective.

Greater alignment on these issues would also assist the market from an insurance perspective. A clearer industry framework could help parties determine when a particular endorsement or additional insurance product is necessary, what specific risks it is intended to cover, whether such coverage is meaningfully available in the market, and, in general terms, what premium implications may follow. Likewise, a more standardized market approach, including broadly accepted clause language, would improve predictability and reduce the uncertainty that currently arises when these issues are addressed inconsistently across lease and finance documentation.

7.- War Risk Insurance primarily covers physical loss of or damage to an aircraft arising from war-related perils, including terrorism, sabotage, hijacking, and other violent political events What is War? Understanding Aviation War Risk Coverage, Insurance Policyholder Advocate | Insights | Jones Day

COELUM

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Vera has over 10 years of experience representing financiers and lessors in financing and leasing of their aircraft in Mexico. She negotiates the contractual rights and designs financing and corporate structures for aviation finance in Mexico and Latin America. She manages the registration and enforcement of Sierra LATAM clients' rights. Vera has successfully negotiated settlements for the repossession of assets through alternative methods of dispute resolution.

Education

- Attorney at law by Instituto Tecnológico de Estudios Superiores de Monterrey in Mexico City
- Master in Laws in Corporate Law by Universidad Panamericana
- Postgraduate studies in corporate law by Instituto Tecnológico Autónomo de México.
- Aviation Contracts Law, Aircraft Acquisition and financing and Law of Aviation Insurance by IATA

Memberships

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- Vera has written multiple articles related to aircraft finance and leasing in COELUM and TERRUM.

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