

# The prospective UNIDROIT Convention on international interests in mobile equipment as applied to space property

*Dara A. Panahy* \*

*Raman Mittal* \*\*

## I. – PURPOSE OF THE CONVENTION

A new international Convention sponsored by UNIDROIT and currently under consideration by numerous countries, will significantly facilitate asset-based financing of satellites and other space property. In order to assist asset-based financing of high value mobile equipment, the future Convention on International Interests in Mobile Equipment (the “Convention”) creates a uniform international system to register security interests in a variety of high-value mobile equipment including airframes, aircraft engines, oil rigs, containers, railway rolling stock and space property, and thereby reduces certain risks associated with the financing of such equipment. The Convention, as applied to space property, helps finance the acquisition and use of space property as efficiently as possible by establishing clear, substantive and commercially oriented international rules to govern such transactions and by creating and administering an international registry for registering international interests in space property.

## II. – INTEREST IN THE CONVENTION AND THE SPACE WORKING GROUP

A wide range of parties in the space sector, including satellite manufacturers, launch services providers, satellite operators, financial institutions and governments encouraging privatization and commercial activities are

\* Associate, *Milbank, Tweed, Hadley & McCloy LLP*, New York (United States of America).

\*\* Candidate, Master of Space Studies, International Space University (United States of America).

interested in the envisaged Convention. It is expected that more than 1,000 commercial communications satellites, valued at over US\$5 billion, will be launched over the next 10 years. Commercial mobile, broadcast and telecommunications satellite services should witness 30% annual growth (including manufacturing – growth projections are 17% annually) over the next decade. In the same period, approximately 40 launches of commercial satellites are expected per year, representing more than US\$20 billion in revenues. Average satellite system project costs, including the satellite, long-lead items for a back-up satellite, launch services, insurance and terrestrial control facilities, range from US\$500 million to US\$1 billion.

The Space Working Group (“SWG”) is a body composed of representatives of the worldwide aerospace industry, satellite operators and the financial community. Participants include: Arianespace, Deutsche Bank, Hughes Communications and Space Company, Inmarsat, Lockheed Martin Finance Corporation, Lockheed Martin Global Telecommunications, Space Systems/Loral and Milbank, Tweed, Hadley and McCloy LLP. The SWG was formed in 1997 for the purpose of promoting the space industry’s interests in connection with the future Convention and to prepare the Space Property Protocol, as contemplated by the Convention.

### III. – STRUCTURE OF THE FUTURE CONVENTION AND ITS RELATIONSHIP WITH THE PROSPECTIVE SPACE PROPERTY PROTOCOL<sup>1</sup>

In order to address adequately the unique aspects of each category of mobile equipment, the preliminary draft Convention contemplates the formulation of individual protocols to govern each category of mobile property. The Convention provides a general conceptual framework while the relevant protocols apply to particular categories of identifiable high value mobile equipment. As a result, the Convention applies to any category of equipment covered by a protocol, only as among contracting States to that protocol, and subject to the terms of such protocol. The protocol structure permits flexibility in adapting the Convention principles to a unique class of assets and accommodates a deliberative process and consensus building. As the Convention is subject to the terms of each protocol, the two texts are to be read and interpreted as a single instrument with no distinction being made between the terms of the Convention and the protocols.

The approach of a framework Convention with controlling protocols may be considered unorthodox as protocols conventionally serve as subsequent amending instruments. Nevertheless, this approach has been contemplated by customary international law as evidenced by and codified

<sup>1</sup> A working draft (January 1999) of a preliminary draft Protocol to the preliminary draft UNIDROIT Convention on International Interests in Mobile Equipment on Matters Specific to Space Property is reproduced in Appendix IV to this volume. Like the working draft itself, this paper is based on the texts of the preliminary draft Convention and, where appropriate, of the preliminary draft Aircraft Protocol submitted to the First Joint Session (Rome, 1–12 February 1999) of the UNIDROIT Committee of governmental experts for the preparation of a draft Convention on international interests in mobile equipment and a draft Protocol thereto on matters specific to aircraft equipment and the Sub-Committee of the ICAO Legal Committee on the study of international interests in mobile equipment (aircraft equipment), references: UNIDROIT 1998, Study LXXII – Doc. 42 / ICAO ref. LSC/ME-WP/3 and UNIDROIT 1998, Study LXXIID – Doc. 3 / ICAO ref. LSC/ME-WP/4, respectively (changes made during the First Joint Session to the latter versions of the preliminary draft Convention and the preliminary draft Aircraft Protocol are apparent in Appendices I and II to this volume).

in the Vienna Convention on the Law of Treaties,<sup>2</sup> which defines “treaty” to include “two or more related instruments”.

#### IV. – THE SPACE PROPERTY PROTOCOL

The Space Property Protocol is particularly important because the nature of and the jurisdictional issues involved with space property are quite different and unique in many respects from other categories of mobile equipment. For example, space property is not within the territory of any State once it is launched into space. Moreover, future applications of space technology are likely to result in space property that is manufactured in space. Accordingly, the method by which a security interest in space property is recorded and enforced, along with special remedy provisions, will be detailed in the Space Property Protocol.

A further *raison d’être* for the Convention and the corresponding Space Property Protocol lies in the fact that many legal systems do not adequately provide for the registration and perfection of a security interest in space property. In those jurisdictions that recognize non-possessory pledges of personal property and that have debtor-based systems of recording security interests, such as jurisdictions whose legal systems derive from British common law, a security interest in an orbiting satellite can be created in the same manner as ordinary earth-based collateral. For example, APT Satellite Company, a Hong Kong corporation, obtained financing for the manufacture, launch and operation of its APSTAR satellite, granting under Hong Kong law a first priority security interest in the satellite and its associated rights. However, in many common law jurisdictions, the rules governing perfection are those established by the jurisdiction in which the property is located. This creates special problems for space property.

Many civil law countries, however, follow a different system. For instance, in a recent transaction involving the Indonesian satellite owner and operator, P.T. Asia Cellular Satellite (ACeS), the method chosen to assign as security an interest in the GARUDA satellite was by a fiduciary

<sup>2</sup> 23 May 1969, 1155 *United Nations Treaty Series* 331 (the “Vienna Convention”).

transfer agreement, governed by Indonesian law, whereby ACeS transferred title to the satellite and certain other personal property to a security agent acting in a fiduciary capacity. The grant of security in these assets is not well developed in Indonesia. Finally, in the United States, because orbiting satellites are neither within the jurisdiction of any State nor fit plainly into the category of “ordinary goods”, “mobile goods” or “general intangibles”, a creditor has no certainty that filing financing statements in any jurisdiction will perfect a security interest.

While this gap in many States’ legal regimes is not new, the nature of satellite financing has changed markedly in the last decade, thereby increasing the necessity for an appropriate legal regimen. In particular, a new type of financing customer has gained prevalence. Previously, commercial satellites were owned and transponders were leased almost exclusively by governmental agencies and well-capitalized, blue chip companies. Asset-based financing in the satellite area was therefore limited. Instead, financiers were adequately comforted by the sovereign credit of the governmental agency or the strength of the balance sheet of the commercial borrower or by taking a security interest in other earth-based and more readily marketable assets of the debtor. Thus, if a debtor defaulted on a loan made to finance the manufacture and use of a satellite or to finance the lease of a satellite transponder, the financier could rely on the assets of the company as a whole. More and more frequently, however, satellite owners and lessors are start-up companies with limited capital, unproven credit-standing and little history of operating success. Often the satellite or the transponder and its associated rights, such as contractual and licensing rights, are the only significant assets of the company. Consequently, the ability to take a valid, perfected security interest in these assets may determine whether or not a satellite project can be successfully implemented.

## **V. – MAIN FEATURES OF THE FUTURE CONVENTION AND THE PROSPECTIVE SPACE PROPERTY PROTOCOL**

### *A. Defining space property*

The first and foremost task of the SWG is to define “space property”. The definition, which extends beyond the satellite itself, contemplates: (1) objects manufactured on earth and launched in space such as satellites, platforms and components of different types; (2) objects assembled or manufactured in space such as commercial space station modules and equipment; and (3) objects manufactured in space and returned to earth such as hardware, ultra-pure crystals and pharmaceuticals.

Obtaining a security interest in an orbiting satellite clearly does not benefit a creditor if, upon default, the creditor is limited to physical or constructive possession of the satellite. Thus, the definition of “space property” has to necessarily include at a minimum the following rights associated with the operation of a satellite: (1) governmental licenses and permits the assignment of which is permissible under local law; (2) intangible rights necessary to control, operate or transfer ownership of or rights in the space property; (3) contractual rights relating to the launch and operation of the satellite; and (4) proceeds and revenues derived from the operation of a satellite. There is great significance in intangible rights and “control” in the context of “associated rights” such as governmental authorizations, intellectual property required to control, use and operate equipment, contractual rights such as warranties, etc. Space property, naturally, encompasses a broader category of rights than is the case for other assets covered by the Convention.

#### *B. Forms and constitution of international interests*

The notion that lies at the conceptual center of the future Convention and the prospective Space Property Protocol (together, the “Texts”) is that of an international interest, which means a proprietary interest in mobile equipment, created by virtue of the provisions of the Convention and its relevant protocol. The Convention sets out three transaction types that create international interests: (1) an interest granted under a security agreement; (2) an interest vested in a conditional seller under a title reservation agreement; and (3) an interest vested in a lessor under a leasing agreement. These three categories have been employed to respect the majority of legal systems that

draw distinctions between security and title-type interests. The Convention points to the “applicable law” to determine the category to which an interest belongs. There are some substantive distinctions in the Texts regarding treatment of different categories of international interests; the most important among them being the separate default remedies.

The international interest contemplated under the texts is “autonomous” in the sense that it is not derived from or dependant upon any particular national law. That means the interest will be enforceable between transaction parties in any Contracting State irrespective of whether or not the interest also constitutes a national security type or leasing interest in that State. “National law” referred to in the Texts as “applicable law” nevertheless remains relevant under the legal regime established by these Texts: beyond direct references addressing specific issues such as constitution of international interests in mobile equipment or remedies, there is a gap filling, or residuary provision contained in the Convention, which sets forth that issues not expressly settled by the Texts or the general principles on which they are based are to be settled in conformity with the “applicable law”.

An international interest is created where the agreement creating or providing for the interest satisfies four conditions specified in the Convention: (1) the agreement must be in writing; (2) the agreement must relate to an object in respect of which the chargor, the conditional seller or lessor has power to enter into the agreement; (3) the agreement must describe the object with reference to the manufacturer’s name, manufacturer’s serial number and its model designation; and (4) in the case of a security agreement, the agreement must enable the secured obligations to be identified. The satisfaction of the foregoing conditions is both necessary as well as sufficient to constitute an international interest.

### *C. Jurisdiction*

The Texts provide three sources for the exercise of jurisdiction. These are courts of the Contracting State where: (1) the object is within or is physically controlled from the territory of that State; (2) one of the parties

or the defendant is located within its territory; or (3) the parties have agreed to submit to the jurisdiction of that court. These courts may exercise jurisdiction even if litigation on the merits of a dispute takes place in another State or arbitral tribunal. The provisions addressing jurisdiction are drafted narrowly to relate solely to the courts that have jurisdiction to grant judicial relief under the judicial relief rule. However, such jurisdiction does not empower the national courts to issue orders, give judgements or issue rulings that purport to bind the international registry established to record international interests. Some of the issues presently under consideration with regard to jurisdiction are whether jurisdictional grounds set out in the Texts are to supplement other grounds that exist under the rules of private international law (*i.e.*, should they be exhaustive, should the grounds mentioned in the Texts be used exclusively or concurrently, and if used exclusively, what should be the hierarchy of the courts in this regard?)

#### *D. The International Registry System*

##### 1. Generally

One of the most important features of the future Convention is the establishment of an international registry for each category of mobile equipment under which creditors will have the ability to centrally register their security interests and search for competing security interests. The international registry system is pivotal to the whole exercise of creating international interests in mobile equipment. The international registry shall have an international legal personality and legal capacity to exercise its functions, will not be subject to any particular national law and will also be entitled to immunity from legal process (unless immunity is waived by the registry). In determining the priority of conflicting interests, the sequential ordering of registration shall be the sole criteria for all priority determinations not involving preferred non-consensual rights and interests.

A registered interest has priority over a subsequently registered interest and over an unregistered interest, whether or not the unregistered interest is



eligible for registration. Thus, the first party to file wins even if the party was aware of the competing interest at the time of registration. Although this seems to be a severe rule, the arguments in favor of the “first-to-file” concept are based on the availability of relevant information upon reasonable search and hence the opportunity to protect one’s interest by registration or withholding funds. As the international registry system contemplated under the Texts is intended to provide easily accessible information regarding potentially competing interests in a particular transaction to any interested party, the burden or allocation of risk to a subsequent-in-time registrant should be minimal.

The registration of interests alone is not a condition to the creation of such interest, nor is it an aspect of validity or enforceability *inter se*. If an invalid interest has been registered, the mere fact of registration will not cure such defect. Registration provides notice of the potential existence of superior interests to a registrant and enables such person to establish its priority. Thus, unlike land registries, the function of the registry contemplated under the Texts is not to guarantee title or other property interests.

## 2. Treatment of non-consensual and prospective interests

The Texts contain provisions relating to the treatment of non-consensual rights and interests. Such rights are included in the general priority scheme based on the reasoning that such inclusion will ultimately enhance the utility of the international registry system. A Contracting State has the option to set out categories of non-consensual rights and interests and on the basis of such categorization, such rights and interests will be registrable as international interests. If a Contracting State thinks that certain non-consensual rights and interests can be treated fairly by participating in a first-to-file regime, it can indicate so in its ratification instrument.

The Convention and the relevant protocol also permit the registration of prospective interests. This serves two purposes: first, it puts others on notice of future interests, and second, it ensures the priority of the prospective interest for the registrant. Upon the fulfillment of the conditions and

requirements prescribed by the relevant protocol, the prospective interest becomes an actual interest and the priority of that interest is determined with reference to the date of the filing of such prospective interest.

While the Convention and the Aircraft Protocol distinguish between an international and an intergovernmental regulator, contemplating the establishment of an international registry and designating the registrar to operate the international registry authority, the SWG seeks to simplify this approach by designating a single entity, the international registry authority, to be responsible for establishing and operating the international registry. The SWG has made preliminary contact with the United Nations Office for Outer Space Affairs to inquire as to a suitable United Nations agency to act as the “International Registry Authority” for international interests in space property.

### 3. Modalities, liabilities and immunities of the International Registry

The Texts will set out the conditions and requirements necessary to give effect to registration. Registration becomes effective upon entry of required information into the registry database so as to permit such registration to be easily searchable. A certificate will be issued by the international registry to that effect, which shall be *prima facie* proof of the validity of the facts contained therein. Other regulations will address matters such as the medium of information transmission to the registry, the duration period for a registration and the requirements of conducting a search.

In order to insure that effective searches of the international registry are possible, the Texts envision the establishment of reliable and consistent criteria to identify property to be registered pursuant to the Convention and applicable protocol. Given the diverse nature of space property as described in the Space Property Protocol, the Protocol proposes that search criteria for space property be the name of the obligor or the manufacturer’s serial number. This provision will require further deliberation to refine the criteria under which all forms of space property are registered and searched in the international registry.

Once effective registration has taken place, the international registry shall be liable to compensate for loss suffered by any person due to any error or system malfunction in the registry. The courts of the State where the registrar of the international registry is situated shall have jurisdiction to resolve any disputes arising out of the liability provision. These provisions are essential to build confidence in the international registration system, particularly during its infancy. Subject to the above provisions the international registry, the registrar and the staff of international registry shall, in exercise of their functions, enjoy immunity from legal process. The assets, documents and archives of the international registry shall also be inviolable and immune from seizure or legal process.

*E. Remedies available upon default*

Another core provision of the Texts is a default remedy provision that permits the holder of a security interest to take certain actions without regard to the location of the asset in which the security interest is registered. The texts include the basic remedies available to the obligee upon default by the obligor. In the event of default in the performance of a secured obligation, the chargee may: (1) take possession or control of any object charged to it; (2) sell or grant a lease of any such object; (3) collect or receive any income or profits arising from the management or use of any such object; and (4) apply for a court order authorizing or directing any of the above acts. In the event of default by the conditional buyer under a title reservation agreement or by the lessee under a leasing agreement, the conditional seller or the lessor, as the case may be, may terminate the agreement and take possession or control of any object to which the agreement relates. The conditional seller or the lessor may also apply for a court order authorizing or directing either of the foregoing remedies. In the event of default, the obligee may change or cause to be changed any access or command codes required to facilitate access to, and the command, control and operation of the space property.

The most likely and effective remedy with respect to an orbiting satellite is the taking of constructive repossession (or control) through telemetry, tracking, and command (TT&C). The most expeditious means of taking control

is by using the existing TT&C facility. As this may pose legal and practical difficulties, the obligee should be entitled to seek judicial relief in any country that would have “line of sight” of the satellite.

The transaction parties are at liberty to provide in their agreement the circumstances that will give rise to remedies (*i.e.*, the parties are free to define “default”). In the event the parties are unable to define “default”, a “substantial default” will be required in order to give rise to remedies under the Texts. It is important to note that the basic remedies set out in the Texts are not exhaustive. Additional remedies permitted by the applicable law, including any remedies agreed upon by the parties, may be exercised to the extent they are not inconsistent with the mandatory provisions of the Texts.

#### *F. Exercise of remedies*

All the remedies stated above are to be exercised in a “commercially reasonable manner”. Keeping in view the litigation implications of such a general standard and the sophisticated nature of parties involved in space property financing, the Space Property Protocol further provides that an agreement between an obligor and an obligee as to the definition of what a “commercially reasonable manner” is shall be conclusive as between the parties. However, this agreement is subject to three exceptions. First, an obligee may not take possession or control of space property in a manner that contravenes “public order”. The phrase “public order” has to be interpreted narrowly. This derives from the provision that disruption of one or more communications systems or operational systems, of which the space property constitutes an integral part, shall not in itself be deemed to contravene “public order”. It follows that the essence of the “public order” exception in this context is harm to persons or property or the violation of property rights. As a result, consideration is required as to the effect of exercising control where the result may be significant disruption of communications. Safety issues have to be considered where communications include navigation, telecommunications and safety/distress applications. From a practical standpoint, these issues will

affect the exercise of remedies. Second, in accordance with the Convention, to safeguard the interest of junior creditors and the obligor in space property, a chargee may not exercise sale or release remedies without giving interested persons at least ten working days prior written notice. Third, no such remedies shall be exercised without the prior written consent of the holder of any higher-ranking registered interest.

All the remedies provided by the Texts are to be exercised in conformity with the relevant procedural laws of the place where the remedy is sought to be exercised. The Texts do not provide for the application of uniform procedural laws for the enforcement of remedies in Contracting States. This is due to the sensitive nature of and the great diversity between the procedural laws of different States. Any remedy available to the obligee, which does not require the application to a court, may be exercised without the leave of the court. This provision of the Convention recognizes the importance of extrajudicial remedies or self help. Since most civil law systems strongly oppose the application of extra-judicial remedies and their application may raise public policy concerns, a provision has been made to specifically permit a reservation on this matter by any Contracting State. The Texts, therefore, try to strike a balance between what is commercially prudent and legally permissible.

#### *G. Expedited remedies*

The timeframe in which the above stated remedies can be enforced is of paramount importance and may vary from one legal system to another. The effects of protracted justice and procedural delays are significant to obligees since equipment that requires immediate preservation necessitates speedy judicial relief. The Texts contain a provision entitling an obligee that adduces *prima facie* evidence of default by an obligor to “speedy judicial relief” in the form of a variety of court orders. A Contracting State shall ensure that an obligee that adduces *prima facie* evidence of default by the obligor may, pending final determination of its claim, obtain speedy judicial relief in the form of one or more of the following orders:

- (a) preservation of the object and its value;
- (b) possession, control, custody or management of the object;
- (c) sale or lease of the object;
- (d) application of the proceeds or income of the object; and
- (e) immobilization of the object.

These provisions will not restrict the right of transaction parties to simultaneously proceed with litigation on the merits of the case. These provisions are, in any case, not intended to be exhaustive and are in addition to interim judicial relief under the relevant “applicable law”. In fact the provisions relating to speedy judicial relief contained in the Texts are *sui generis* and not dependent upon or derived from national injunctive relief rules. While the purpose of national injunctive rules is fairness, equity and prevention of irreparable damage, the purpose of speedy remedies under the Texts is commercial prudence in the light of an objective standard of *prima facie* proof of default. In the event Contracting States wish to retain national injunctive relief, they may enter a reservation to this effect.

#### *H. Effect of insolvency of international interests*

An international interest is valid against the trustee in bankruptcy of the obligor if the interest was registered prior to the commencement of bankruptcy proceedings. This provision seeks to ensure that the proprietary nature of a registered international interest will not be set aside or subordinated in insolvency proceedings in a Contracting State on account of failure to comply with applicable national requirements. The provision is positive in nature rather than negative as it does not affect the validity of an unregistered international interest against the trustee in bankruptcy where that unregistered interest would be valid under applicable insolvency law. Once again, recognizing the party autonomy principle and the sensitivity of insolvency law, reservations by a Contracting State are permitted by the Convention. The Texts require the courts of a Contracting State from where space property is controlled, States having a close connection with the

property or the State where the obligor is located, to expeditiously cooperate with and assist the court or other authorities administering the principal insolvency proceedings in respect of an obligor.

*1. Assignment of international interests*

The holder of an international interest may assign all interests and priorities to another person wholly or in part. For all practical purposes, the assignee has rights analogous to those of the obligee. The provisions of the Texts regarding registration of international interests apply to the registration of an assignment as if the assignment or prospective assignment were an international interest or prospective international interest. Where the assignment is by way of security, in the event of default by the assignor, the assignee may exercise a set of remedies analogous to those held by a chargee under a security agreement. A registered assignment shall also be valid against the trustee in bankruptcy of the assignor. In the event of competing assignments, priority will be determined on the first-to-file basis as previously discussed. An obligor is bound by a valid assignment and has a duty to make payment or provide other performance to the assignee if written notice to such effect has been given by the assignor and the notice identifies the international interest.

**VI. – CONCLUSION**

There are three principles that underlie asset-based financing. They are: (1) transparency in the priority principles under which proprietary interests are registered; (2) prompt enforcement of remedies; and (3) comfort that the foregoing priority principles and enforcement mechanisms will not be modified or qualified due to bankruptcy of the obligor. Some of the provisions embodying the above principles, as drafted in the proposed Convention and Space Property Protocol, may raise fundamental policy questions for certain countries regarding insolvency rules, timetables applicable to legal proceedings and the ability to take possession of assets without the need for judicial proceedings. The Texts contain provisions that specifically contemplate and permit reservations in respect of these crucial matters. While use of reservations to address policy issues is customary, their use as a basic

feature of these treaty instruments is innovative. At the time of ratification, Contracting States will be given the opportunity to weigh their economic and non-economic interests and policies and decide whether to opt for these critically important provisions or not. Although the elective nature of these provisions may have important financial implications, this structure permits the future Convention and Space Property Protocol to be tailored to address multiple economic, financial and political concerns.

An international Convention for the registration of security interests in space property will facilitate and expand space commerce. Space and satellite finance is still in its infancy when compared to other forms of equipment finance. Aerospace manufacturers are still evolving from government contractors to investors in space and satellite projects. Financial institutions are still learning about industry needs and the particular risks of space financing. The need of asset-based financing and leasing is now emerging in an environment driven by privatization, deregulation, global demand and increased international trade. The space sector, including satellite manufacturers, launch services providers, satellite operators and financial institutions, can benefit greatly from the uniform and predictable regime governing security interests in space property as provided for by the future Convention and by the prospective Space Property Protocol.

[Uniform Law Review / Revue de droit uniforme, (1999), pp. 303–312.]