

UNIDROIT 1997
International Interests /
Study Group/Drafting Group
Fourth session / W.P. 4
(Original: English)

U n i d r o i t

INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW

STUDY GROUP FOR THE PREPARATION OF
UNIFORM RULES ON INTERNATIONAL INTERESTS IN MOBILE EQUIPMENT:

DRAFTING GROUP
(Fourth session: Würzburg, 24-26 July 1997)

*REVISED DRAFT ARTICLES OF A FUTURE UNIDROIT CONVENTION
ON INTERNATIONAL INTERESTS IN MOBILE EQUIPMENT*

(prepared by the Chairman of the Study Group in the light of the deliberations of that Group at its third session, held in Rome from 15 to 21 January 1997, and of the proposals by the Drafting Group at its third session, held in Rome on 17 and 20 January 1997) :

PRELIMINARY COMMENTS

on the application of the revised draft articles to space property

(submitted by the Space Working Group)

Rome, July 1997

July 16, 1997

To the International Institute for the Unification of Private Law: Drafting Group of the Study Group for the Preparation of Uniform Rules on International Interests in Mobile Equipment (Fourth Session (Würzburg, July 24-26, 1997))

Dear Drafting Group Members:

The Space Working Group was formed in Los Angeles on July 1, 1997 to provide comments to the Revised Draft Articles of a Future Unidroit Convention on International Interests in Mobile Equipment (the "Draft Articles") relating to space-based equipment.

Founding members of the Working Group include space equipment manufacturers, launch services providers, financiers, satellite systems operators and customers of satellite services. A list of founding members is attached to this letter (*APPENDIX I*). Also attached is a list of organizations invited to attend our founding meeting and which were informed about the activities of our proposed Working Group (*APPENDIX II*). Membership is open to all.

We believe the Draft Articles are valuable and will facilitate the financing of space property. To be most useful for space equipment financing, these Draft Articles must recognize the unique attributes of this type of mobile equipment (whether in the Draft Articles or by separate Protocol).

Few national legal systems provide a comprehensive means of recording security interests in space equipment and appurtenant rights. Any international regime governing interests in mobile equipment that will include space equipment should consider carefully the special characteristics of space equipment.

Space is international and not subject to national appropriation. While ownership of objects launched into space is not affected by their presence in space, laws designed for equipment present mostly within or between national territorial boundaries are not always suitable for space-based equipment.

To date, most financing of space equipment has involved satellites and transponders. However, in this rapidly developing field, new types of equipment that may be financeable (particularly in relation to the construction and operation of space stations and exploration of celestial bodies) must be considered.

Unlike many other types of mobile equipment that have inherent value and may be physically repossessed, the inherent value of equipment in space is often determined by the availability of appurtenant rights such as intangible rights (licenses to use equipment, software and contract rights) and proceeds and revenues (income, insurance and warranty claims).

Earth-based mobile equipment typically moves from jurisdiction to jurisdiction. Space equipment, on the other hand, usually moves from one jurisdiction subject

to national law to space, which is subject to international law and, in the case of some space equipment (such as reusable launch systems or property retrieved from space), returns to a national jurisdiction.

Many of the unique attributes of space equipment and financing have been noted in the attached preliminary comments to the Draft Articles. We wish to emphasize that these comments reflect diverse issues raised during our first Space Working Group meeting and do not purport to reflect the viewpoint of any particular organization. Nor are they comprehensive or final.

The Space Working Group has been formed to represent the particular concerns of the space industry and finance community relative to space equipment financing. We are mindful of the broader issues involved in formulating an international convention. The comments we have attached to this letter are intended to inform the Unidroit Study Group of specific issues of concern regarding space equipment and to demonstrate the strong interest the Space Working Group has in participating in the drafting process for this very important Convention.

Sincerely,

Space Working Group

By: _____/s/
Scott H. Siegel, Lockheed Martin Finance Corporation
Professor Dan S. Schechter, Loyola Law School
Peter D. Nesgos, Winthrop, Stimson, Putnam & Roberts

Specific Comments of the Space Working Group on the February 1997 version of the Revised Draft Articles of a future Unidroit Convention on International Interests in Mobile Equipment

In these Comments, the Space Working Group will not address all of the Articles, and particularly not those promulgated in May of 1997. However, it is possible (and even probable) that we will have additional comments upon subsequent review. Our suggested amendments are underlined.

Article 1

We suggest that in the context of space property, both sellers and buyers under title reservation agreements, as well as lessors and lessees under leasing agreements, should be included as possible chargors of international interests. Financiers extend credit to a variety of parties who own or lease space property. Those parties include sellers, buyers, lessors, and lessees. [The revised definition of "obligor" in the May, 1997, materials appears to be consistent with this idea.] Our suggested language would permit registration of international interests in the rights of those parties:

2. – For purposes of this Convention an international interest in Mobile Equipment is an interest in an object of a kind listed in Article 2:

- (a) granted by the chargor under a security agreement; or
- (b) vested in a person who is the seller or buyer under a title reservation agreement; or
- (c) vested in a person who is the lessor or lessee under a leasing agreement.

It is possible that other types of mobile equipment, such as rolling stock, may benefit from the change in paragraph 2 of Article 1. If Unidroit decides not to amend Article 1, perhaps paragraph 2(d) could state expressly that the definition of an "international interest" may be expanded in a specific protocol.

Article 2

We suggest that paragraph 1(h) be changed from "satellites" to "space property." The term "space property," which is defined more fully in the Definitions in the Appendix, below, encompasses many types of space-based equipment and rights. Currently, communications satellites, transponders, licenses, contract rights, insurance and other related rights are the only commercially significant space property. In the future, there may be other types of space property that will need financing, such as equipment used on space stations and reusable launch systems. Perhaps mining facilities on other celestial bodies may someday be feasible. A broad definition of space property means that this Convention may be sufficient to protect international interests in those other types of property, without the necessity of subsequent amendments.

The Space Working Group would like to reserve comment on paragraph 3 of Article 2, as well as on Article 3, both of which contain important procedural rules concerning the implementation of the Convention.

Article 7

We suggest that paragraph (b) of Article 7 include lessees and buyers, in conformity with our suggestion concerning Article 1. In addition, we suggest that paragraph (c) of Article 7 indicate that the method of properly identifying an object may be described in a specific protocol. We suggest the following language:

An interest takes effect as an international interest under this Convention where the agreement creating or providing for the interest:

- (a) is in writing;
- (b) relates to an object in respect of which the chargor, seller, buyer, lessor, or lessee has power to enter into the agreement;
- (c) identifies the object in conformity with the standards described in the appropriate protocol, if an applicable protocol has been adopted;
- (d) in the case of a security agreement, identifies the secured obligations expressly or by reference to another document.

Article 8

Under current Article 8, paragraph 1 (a), the chargee may take possession of the object. However, it is usually not feasible to take actual physical possession of space property. It is, however, fairly easy to take constructive possession of some space property by taking command of the ground-based telemetry, tracking, and control ("TT&C") equipment. Control of TT&C is a functional alternative to possession of various types of space property. Therefore, we suggest that "control" be added to paragraph 1 (a). Alternatively, we suggest expanding the term "possession" to "actual or constructive possession" may achieve the same goal.

Under paragraph (3), the chargee may sell the interest of the chargor. Occasionally, it will be more economically feasible to lease the chargor's interest, especially if the chargor is itself a lessee. That idea seems to have been considered in the drafting of paragraph (1) (b).

In conformity with those suggestions, we suggest the following amendments to Article 8:

1. – In the event of default in the performance of a secured obligation, the chargee may exercise any one or more of the following remedies:

- (a) take possession or control of any object charged to it;
- (b) sell or grant a lease of any such object;
- (c) collect or receive any income or profits arising from the management or use of any such object;
- (d) apply for a court order authorising or directing any of the above acts.

3. – A chargee proposing to sell or lease an object under paragraph 1 otherwise than pursuant to a court order shall give reasonable notice of the proposed sale or lease to interested persons.

Article 9

Article 9, paragraph 1, provides that "ownership" of the object may vest in the chargee after default. Sometimes, however, the chargor may not own the object in question but may simply be a lessee or may have other limited rights. Therefore, the chargee cannot take ownership of the object but will succeed to the rights of the chargor. We therefore suggest the following amendments to paragraphs (1) and (4):

1. – At any time after default in the performance of a secured obligation, all the interested persons may agree, or the court may on the application of the chargee order, that ownership of (or any other right of the chargor in) any object covered by the security interest shall vest in the chargee in satisfaction of all or any part of the secured obligations.

4. – Ownership or any other right of the chargor passing on a sale under paragraph 1 of Article 8 or passing under paragraph 1 of this Article is free from any other interest over which the chargee's security interest has priority under the provisions of Article 24.

Article 10

Currently, Article 10 permits sellers and lessors to terminate sales or leasing agreements after default by the buyer or lessee. Sometimes, however, the rights of buyers and lessees may be subject to registered interests in favor of chargees. We believe that sellers and lessors are permitted to modify their rights of termination in their agreements, in order to protect holders of interests in the rights of buyers and lessees. The following language reinforces this concept. We also suggest that the sellers or lessors be permitted to take control in lieu of possession, in conformity with our discussion of paragraph (1) (a) of Article 8:

In the event of default by the buyer under a title reservation agreement or by the lessee under a leasing agreement, the seller or lessor, as the case may be, may terminate the agreement and/or take possession or control of any object to which the agreement relates; provided, however, that the seller or lessor may waive its right of termination.

Article 14

We suggest that paragraph (2) (b) be amended to include the alternatives of possession or control.

We suggest that paragraph 3 should empower the protocol to provide that the parties may by agreement confer jurisdiction on a specific Contracting State to hear any or all disputes concerning the object in question.

We suggest that a new paragraph (5) be added to encourage comity.

Our suggested language follows:

2. – The forms of judicial relief available before trial shall include the following orders:

- (a) preservation of the object or 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;
- (e) immobilisation of the object.

3. – A court of a Contracting State has jurisdiction to grant provisional or interim judicial relief under this Article where the object is within the territory of that State or one of the parties has its place of business within that territory, even if the trial referred to in the preceding paragraph will or may take place in a court of another State; provided, however, that the parties may by agreement confer jurisdiction on a specific Contracting State to hear any or all disputes concerning the object in question, if authorized by the applicable protocol.

5. – Subject to the public policy of each Contracting State, a Contracting State shall recognize the orders, rulings, and judgments issued by courts of competent jurisdiction of other Contracting States that arise out of this Convention and are consistent with this Convention.

Article 16

[Our comments concerning Article 16 of the February, 1997, draft may have been superseded by the amendments proposed in May of 1997. If the May, 1997, amendments are not adopted, however, our comments on Article 16 may again become relevant.]

The February, 1997, draft of Article 16 (2) appears to require serial numbers. In the context of satellite manufacturing, satellites not yet manufactured do not have serial numbers. Therefore, if serial numbers are required for registration under Article 16(2), it will be impossible to file a "prospective international interest" under Article 18. The Space Working Group therefore suggests that the holder of an international interest should be permitted to register in the name of the chargor, together with a satisfactory description of the object. The registration should be amended to reflect a serial number, once it has been issued. Our suggested language follows:

2. – A registration of an international interest in an object shall be recorded and searchable in the data base of the appropriate registry according to the manufacturer's serial number on the object or according to such other asset identification marks on the object as are specified in the Rules or in the applicable protocol, if any; provided, however, that if the serial number or identification mark is unavailable at the time of registration, the holder of the interest shall provide other sufficient identifying information, such as the name of the chargor and a description

of the object, and shall immediately amend the registration to provide serial numbers or identification marks as soon as they become available.

Article 18

We believe that Article 18 (3) of the February, 1997, draft seems somewhat inconsistent with the requirements of Article 17(4). Article 17(4) permits the registry to accept applications solely from the holder and not the chargor. The chargor is empowered to demand that the secured party discharge its registration, but the chargor cannot unilaterally obtain discharge.

By contrast, however, under current Article 18(3) the chargor may require discharge without the holder's knowledge or consent. This leaves open the possibility that a chargor could discharge the registration immediately before the holder advances value to the chargor, thus misleading the holder. We therefore suggest that Article 18(3) might be deleted.

Alternatively, if Unidroit does not want to delete Article 18 (3), we suggest that the Convention might empower the applicable protocol to opt out of Article 18 (3). Our suggested language follows:

3. – The intending grantor of the prospective international interest may by notice to the appropriate registry require the registration to be removed at any time before a prospective grantee of the interest has given value or incurred a commitment to give value; provided, however, that the applicable protocol may elect not to give the chargor or grantor the power to require removal of the registration.

Article 20

Article 20 appears to require strict compliance: Must the registration comply strictly with all requirements of the Convention, or is substantial compliance sufficient? In the context of satellite finance, a "substantial compliance" standard may be necessary when dealing with satellites that have not yet been built and that have no serial numbers. We therefore suggest the following language. If it is not acceptable to the drafters of the general Convention, perhaps it is possible to empower the applicable protocol to define the standard of compliance.

A notice transmitted to a registry pursuant to this Chapter shall be accepted for the purposes of registration only if:

(a) the proposed registration appears to be substantially in conformity with the provisions of this Convention; and

(b) the notice is substantially in the form prescribed by the Rules and is accompanied by such other documents and information, and by such fee or fees, as the Rules require.

Article 21

Paragraph (1) of Article 21 appears to permit object-based searches. We believe that searches by object, chargor, or holder would prevent the confusion that would result from

an inaccurate Article 21(2)(b) ‘no registration’ report caused by a defective object description within a registration. A search in the name of the chargor or the holder might reveal an imperfect registration and would thus avoid unnecessary conflicts. If the general Convention cannot permit searches by chargor or holder, perhaps the applicable protocol could define the nature and scope of the search. Our suggested language follows:

1. – Any person may make a search in a registry concerning any object, any chargor, or any holder of an international interest.

Article 24

The Space Working Group favors Alternative A to Paragraph 2 of Article 24 for two reasons:

(1) Under Alternative B, priority of subsequent advances will depend upon an inquiry into the subjective knowledge of the parties, which is always a difficult question of evidence. The uncertainty created by a knowledge-based standard encourages litigation.

(2) It is often the case that interest will compound under an existing obligation, and the amount of interest may exceed the amount described in the original registration. Under Alternative B, if a junior holder later registers, and the senior holder then learns of that registration, then the subsequently-accruing interest charges will not enjoy the same priority conferred upon the original obligation. The senior holder may therefore be forced to declare a default.

Referring to Paragraph 7 of Article 24, we are concerned that subsequent amendments by Contracting States might impair pre-existing registered interests. We therefore suggest the following language:

7. – In proceedings before the courts of a Contracting State a non-consensual right or interest (other than a registrable national interest) which under the law of that State would have priority over an interest in the object equivalent to that held by the holder of the international interest (whether in or outside the insolvency of the obligor) has priority over the international interest to the extent, and only to the extent, set out by that State in its instrument of ratification, acceptance, approval or accession or any subsequent instrument amending that instrument deposited with the depositary; provided, however, that no such amending instrument can affect interests registered prior to the effective date of that amendment.

Article 27

We believe that paragraph 2 (a) of Article 27 may create substantial difficulties for financing of significant equipment, such as space projects. Often, a major financial transaction is originated by a single institution, which then assigns parts of the obligation to other institutions or investors. We believe paragraph 2(a) should be deleted. If the general Convention retains paragraph (2) (a), we request that the applicable protocol be empowered to delete that provision. The following is the text of the February, 1997, version of paragraph 2 of Article 27:

2. – An assignment of an international interest shall be valid only if it:
 - (a) is made with the written consent of the obligor;
 - (b) is in writing;
 - (c) identifies expressly or by reference to another document the international interest and the object to which it relates;
 - (d) in the case of an assignment by way of security, identifies the obligations secured by the assignment.

Definitions:

In the Definitions, we suggest that the terms "chargor" and "chargee" be defined.

Most significantly, we would like to add the following Definition of "space property", which remains subject to future consideration. Our comments to this Definition follow the text:

“Space property” means:

- (1) any object that is or is intended to be launched or otherwise placed in space, even if returned from space; provided, however, that such an object does not become "space property" until it is in space;
- (2) all physical equipment forming an identifiable part of the space property or attached to or contained within the space property;
- (3) to the extent permissible and assignable under otherwise-applicable law, all permits, licenses, approvals, and authorizations granted or issued by a national or international agency or authority to control, use and operate the space property;
- (4) all intangible rights necessary to control, operate, and transfer ownership of or rights in the space property;
- (5) all contracts and contractual rights relating to the manufacture, launch, operation, control, and tracking of the space property;
- (6) all proceeds and revenues derived from the space property. For purposes of this subparagraph, "proceeds" and "revenues" mean whatever is received upon the sale, lease, use, operation, licensing, exchange, or disposition of space property, including without limitation insurance proceeds.

Comments:

Paragraph 1:

Paragraph 1 describes objects that are or are "intended" to be located in space. Thus, the interest of the holder may be registered even if the object has not yet been launched. The interest itself does not come into full effect until the object is in space. Once in space, the object becomes space property, and it retains that characterization even if it is eventually returned to Earth (as in the case of a reusable space vehicle or an orbiting satellite or other space equipment that is retrieved and returned to the surface of the Earth by a reusable space vehicle or otherwise).

We recognize that the boundary of air and space remains undefined as a matter of international law. Although we would like to propose an arbitrary boundary between air and space, we recognize that this is still a fundamental issue of state sovereignty. Some within the Space Working Group suggested further consideration should be given to proposing a boundary that applies solely in the context of this Convention and that would not affect any other treaties or Conventions.

The broad language of paragraph 1 means that this registry is not limited to orbiting satellites. It also covers interests in manned objects and in space property not in orbit around the Earth.

Paragraph 2:

Paragraph 2 is intended to cover not only the entire space object but also items such as transponders or component parts.

Paragraph 3:

Paragraph 3 is intended to cover a broad range of governmental permits and authorizations, which are a central component of the value of space property. These permits and authorizations include the right to use specific radio- frequencies and orbital positions.

Note, however, that if the governmental or regulatory agency issuing the permits or authorizations has prohibited the transfer or assignment of those rights, the registration of an international interest will not supersede that prohibition. This is very important: we do not intend to impair or affect the sovereignty of any Contracting State.

Paragraph 4:

We have tentatively decided to include intangible rights appurtenant to the space property. We recognize that many such intangibles are already covered by existing registration laws. However, those intangible rights are central to the value of space property, unlike almost any other kind of equipment. We are particularly concerned about technology needed for the telemetry, tracking, and control of the space property.

Paragraph 5:

Paragraph 5 covers all contractual rights connected with the space property, whether arising before or after launch. Although the property does not become "space property" until it is in space, many agreements entered into before launch are relevant thereafter. For example, satellite purchase agreements often contain warranties that are valuable in the event of a post-launch malfunction.

Paragraph 6:

Paragraph 6 includes the proceeds and revenues received (or to be received) by the chargor. The Space Working Group suggests that proceeds and revenues be covered by the registry because the insolvency laws of many nations will not recognize a financier's right to those proceeds and revenues, unless the financier has a properly-registered interest in those proceeds and revenues. Especially in the context of satellite finance, those proceeds and revenues may be the most easily available "space property" that the financier can reach to satisfy an unpaid debt.

We recognize that this definition of proceeds and revenues is very broad, and we are concerned about interfering with existing registration laws currently governing ground-based proceeds and revenues. This issue will require additional discussion and consideration.

Conclusion:

We hope that our suggestions have been useful and relevant. We look forward to your comments. Thank you for reviewing these materials.

APPENDIX I

[Texts of Appendix I and Appendix II not available in electronic form]