INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW
INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE

UNIDROIT COMMITTEE OF GOVERNMENTAL EXPERTS FOR THE PREPARATION OF A DRAFT PROTOCOL TO THE CONVENTION ON INTERNATIONAL INTERESTS IN MOBILE EQUIPMENT ON MATTERS SPECIFIC TO SPACE ASSETS
Fifth session
Rome, 21/25 February 2011

UNIDROIT 2011
C.G.E./Space Pr./5/W.P. 7 Add. 3
Original: English only
February 2011

REVISED PRELIMINARY DRAFT PROTOCOL TO THE CAPE TOWN CONVENTION ON MATTERS SPECIFIC TO SPACE ASSETS

(as amended by the Committee of governmental experts at its fourth session, held in Rome from 3 to 7 May 2010)

Comments

(submitted by Governments, Organisations and representatives of the international commercial space, financial and insurance communities)

INTRODUCTION

Subsequently to the comments on the text of the revised preliminary draft Protocol to the Convention on International Interests in Mobile Equipment on Matters specific to Space Assets as amended by the Committee of governmental experts at its fourth session, held in Rome from 3 to 7 May 2010 (C.G.E./Space Pr./5/W.P. 3) (hereinafter referred to as the *revised preliminary draft Protocol*) reproduced in C.G.E./Space Pr./5/W.P. 7, C.G.E./Space Pr./5/W.P. 7 Add. 1 and C.G.E./Space Pr./5/W.P. 7 Add. 2, the UNIDROIT Secretariat received additional comments from Ms Pamela Meredith, Zuckert Scoutt & Rasenberger, L.L.P. This paper reproduces these additional comments hereunder.

****

COMMENTS AND PROPOSALS SUBMITTED BY GOVERNMENTS ORGANISATIONS AND REPRESENTATIVES OF THE INTERNATIONAL COMMERCIAL SPACE, FINANCIAL AND INSURANCE COMMUNITIES

Ms Pamela Meredith, Zuckert Scoutt & Rasenberger, L.L.P.

The Space Protocol: provisions for insurer salvage

Salvage is a well-established international legal tradition, dating back hundreds of years: The insurer *after having paid the loss* of the insured property is entitled to what is left of it. [1]

[1] Salvage generally refers to "the property saved or remaining after a fire or other loss, sometimes retained by an insurance company that has compensated the owner for the loss," among other meanings. BLACK'S LAW DICTIONARY 1457 (9th ed. 2009). *See also* JOHN A. APPLEMAN, INSURANCE LAW & PRACTICE (Matthew Bender 1st ed. 2007) § 3808 ("[T]he term 'salvage' may also be used . . . as designating that part of the property that survives the peril and is saved.").

Satellite insurance policies typically provide for two types of salvage: (1) "Title Salvage," where the insurer takes title to the defective satellite; and (2) "Revenue Salvage," where the insurer receives a portion of the revenues generated from the operation, or the proceeds from the sale, of that satellite. The insurer must select either Title Salvage or Revenue Salvage.

The Committee of governmental experts, during the sessions in Rome in 2009 and 2010, recognised that satellite insurers' salvage interests require protection under the revised preliminary draft Protocol. In 2010 they agreed to the following provision for Title Salvage: "For the purposes of this Protocol, title to a space asset acquired by an insurer as a salvage interest is treated as if acquired by way of sale." revised preliminary draft Protocol, [2] Art. IV(4).

The 2010 session referred the proposed Revenue Salvage provision in Article IV(5) of the revised preliminary draft Protocol to the Drafting Committee. The clause provides for *subrogation* by insurers to a creditor's registered international interest upon payment of insurance proceeds. The subrogation right extends only so far as the salvage interest (see section III(a), below).

The salvage provisions (Articles IV(4)-(5)) are intended to remedy changes to existing law brought about by the revised preliminary draft Protocol: *a subsequent registering buyer or creditor would wipe out an existing salvage interest even if it knew of the salvage.* This happens because a buyer's or creditor's subsequently registered interest takes priority over unregistered interests, including salvage, which cannot be registered.

Finding a solution for Revenue Salvage is critical given the key role insurance plays in satellite financing. Financiers typically require that the satellite operator obtain insurance as a condition of the financing. Without a resolution for Revenue Salvage, insurers may be required to change the way they write satellite insurance, including features that creditors value. ***Insurers seek merely to preserve the* status quo*.***

I. Satellite insurance salvage

In the United States of America salvage arises as a matter of law. In addition, satellite launch and in-orbit insurance policies typically provide for Title Salvage and Revenue Salvage. These policies protect the satellite owner in the event of a loss of the satellite during launch or malfunction in orbit.

Salvage plays a unique role in satellite insurance owing to these features: (1) the threshold for a constructive total loss is ***low*** in satellite insurance (sometimes as low as 50% of transponders lost), which means the defective satellite may still have many years left in operation; and (2) the insurers pay the ***full value*** of the satellite in the event of a constructive total loss ("agreed-value" policies). The insurers' right to salvage is a critical consideration for these payment terms.

Satellite insurance is also different from aviation insurance in that the satellite insurer cannot inspect or take physical possession of satellite salvage and must rely entirely on the satellite insured to effect the salvage. These restrictions are further compounded by the limited access to technical documents describing the satellite and its operation due to the United States International Traffic in Arm Regulations.

---

[2] Text of the revised preliminary draft Protocol to the Cape Town Convention on Matters specific to Space Assets, *as amended by the UNIDROIT Committee of governmental experts for the preparation of a draft Protocol to the Cape Town Convention on Matters specific to Space Assets at its fourth session, held in Rome from 3 to 7 May 2010,* C.G.E./Space Pr./5/W.P. 3, Nov. 2010, Art. IV(4). See the definition of salvage interest, *id*. Art. I(2)(jj).

II. Why satellite salvage needs protection in the revised preliminary draft Protocol

Salvage interests need protection because they do not qualify for registration under the revised preliminary draft Protocol as an "international interest" or other registrable interest. [3] Registered interests take priority over any unregistered interests, e.g. salvage. Therefore, a buyer or creditor registering a sale of or a security interest in the satellite *after* the insurer has paid for the loss and salvage has vested ***extinguishes the salvage interest***:

- A buyer of the satellite in which insurers have a salvage interest who registers the sale takes title to that satellite free and clear of any "unregistered interest," e.g. a salvage interest. [4]

- A creditor who registers an international interest after the insurer has become entitled to salvage has priority over any "unregistered interest," e.g. salvage interest. [5]

- A creditor who records a debtor's rights [6] assignment (e.g. an assignment of revenues *due to* the insured/debtor) has priority over any other transfer of debtor's rights (such as Revenue Salvage) even if the assignment occurs after the insurer has become entitled to salvage. [7]

This applies even if the new buyer or creditor knows of insurer's salvage. [8] In the event of default on the part of the insured debtor, the new creditor under the revised preliminary draft Protocol may collect precisely the revenue that was the insurer's Revenue Salvage. [9]

III. Revenue Salvage

(a) The current text

The insurers have proposed a subrogation clause to prevent Revenue Salvage interests from being extinguished by subsequently registered sales or registration of creditors' international interests. Under the proposed provision an insurer would be subrogated to a creditor's international

---

[3] An international interest is defined as an "interest held by a creditor" that is: (1) granted under a security agreement, (2) vested in the conditional seller under a title reservation agreement, (3) vested in the lessor under a leasing agreement or (4) vested in a buyer under a contract of sale. Convention on International Interests in Mobile Equipment ("Convention"), Arts. 1(o), 2(2)(a)-(c); *Id*. Art. 41 (providing that Protocols may specify that the Convention shall apply to sales and prospective sales); revised preliminary draft Protocol, Art. IV (applying the Convention to a contract of sale and treating the buyer as the creditor and the seller as the debtor). A salvage interest is not "held by a creditor" as that term is defined. Convention, Arts. 1(i) and 2(2); revised preliminary draft Protocol, Art. IV. Salvage is not an interest granted under a security agreement, because it is not intended "to secure the performance of any existing or future obligation of the [debtor/insured] or a third person." *See* Convention, Art. 1(ii). Salvage is not an interest vested in a conditional seller under a title reservation agreement or in a lessor under a leasing agreement. *See* Convention, Art. 1(q), (ll). Salvage is also not a contract of sale, but the Title Salvage provision in the revised preliminary draft Protocol, Art. IV(4) remedies this.

[4] Revised preliminary draft Protocol, Art. XXIV(1) ("The buyer of a space asset under a registered sale acquires its interest in that asset free from an interest subsequently registered and from an unregistered interest, even if the buyer has actual knowledge of the unregistered interest").

[5] Convention, Art. 29(1) ("A registered interest has priority over any other interest subsequently registered and over an unregistered interest").

[6] Revised preliminary draft Protocol, Art. I(2)(a) (Debtor's rights are "rights to payment or other performance due or to become due to a debtor by any person with respect to a space asset."). An example of a debtor's right is revenue from a transponder lease.

[7] *Id*. Art. XIII(1) (A recorded debtor's rights assignment has "priority over any other transfer of debtor's rights …").

[8] *Id*. Art. XXIV(1) ("even if the buyer has actual knowledge of the unregistered interest."); Convention, Art. 29.2 ("The priority . . . applies: (a) even if the [subsequent interest] was acquired or registered with actual knowledge of the other interest …").

[9] Convention, Art. 8(1)(c) (Creditor may "collect or receive any income or profits arising from the management or use of any such object").

interest and associated rights upon payment to that creditor of insurance proceeds. The subrogation would be limited to the salvage interest.

The 2010 session referred the proposed Revenue Salvage provision in Article IV(5) of the revised preliminary draft Protocol to the Drafting Committee. It currently reads as follows:

> For the purposes of the Convention, when an insurer makes a payment to a creditor of insurance proceeds for a covered loss of an insured space asset in which the creditor has an international interest, the insurer shall, to the extent of the insurer's salvage interest, have the right of subrogation to the creditor's associated rights and related international interest in the space asset and to any debtor's rights assigned to the creditor under a rights assignment or rights reassignment recorded as part of the registration of that international interest. This right of subrogation shall be in addition to and shall not affect any right of subrogation the insurer may have under national law or the insurance policy. [10]

Article I(2)(jj) of the revised preliminary draft Protocol defines a salvage interest as "title to, interest in, or right to funds derived from a space asset to which the insurer is or may be entitled by contract or operation of law upon payment of proceeds following a loss affecting the space asset" [11] This definition is also under review.

(b) Concerns expressed with the subrogation clause

The following concerns have been raised about the proposed subrogation clause for salvage:

(1) subrogation against insurers' own insured is not legal under national law;

(2) insurers would acquire a security interest in the satellite through subrogation that they do not have today; and

(3) subrogation would disturb the priority of international interests in a space asset and create complications for inter-creditor agreements.

We address these concerns below and show that the subrogation approach is valid; nonetheless, insurers are open to compromise solutions and look forward to working with all interested parties to find a mutually acceptable solution.

(c) Subrogation for salvage is permitted: the United States and Canada as examples

While many legal systems have a *general rule* prohibiting an insurer from subrogating against its own insured (the anti-subrogation rule), this rule, at least in the United States and Canada would not apply to salvage, as salvage is intended to prevent *over indemnification* of the insured. In the United States the insurer may subrogate against its insured for reimbursement; [12]

---

[10] Revised preliminary draft Protocol, Art. IV(5).

[11] *Id*. Art. I(2)(jj).

[12] Permitted to prevent over indemnification) (*citing* 31 Fla. Jur.2d Insurance § 149; 12 Fla. Jur. Contribution, etc. §§ 18 and 20; and *International Sales-Rentals Leasing Co. v. Nearhoof*, 263 So. 2d (Fla. 1972)); Lee L. Russ, COUCH ON INSURANCE, § 224.1 (3rd ed. 2003) (cases that allow subrogation against the insured are typically for reimbursement) (*citing AGIP Petroleum Co., Inc. v. Gulf Island Fabrication, Inc*., 920 F. Supp. 1318 (S.D. Tex. 1996) and *Vesta Ins. Co. v. Amoco Production Co*., 986 F.2d 981 (5th Cir. 1993)); *DeHerrera v. American Family Mut. Ins. Company*, 219 P.3d 346, 351 (Colo. Ct. App. 2009) (allowing subrogation against insured for reimbursement and distinguishing the anti-subrogation rule). *See also Vesta Ins. Co.*, 986 F.2d 981, 988 (allowing subrogation against insured for reimbursement); *State Farm Mut. Auto. Ins. Co. v. Perkins*, 216 S.W.3d 396, 493 (Tex. App. 2006) (allowing subrogation against insured for reimbursement). Furthermore, under United States law, the insurer subrogates to creditor's claim against the insured if the insurer pays proceeds to a creditor under a loss payable clause in a situation where the insurer is *not* liable to the insured under the insurance policy (e.g., in the event of the insured's misrepresentation). *See, e.g., Merchants Nat'l Bank v. Southeastern Fire Ins. Co.,* 854 F.2d 100, 105 (5th Cir. 1988) ("An insurer who

salvage is a form of reimbursement. In Canada the Ontario Court of Appeals, in 2009, said that the "right to salvage is simply the exercise of the right of subrogation to prevent over-indemnification [of the insured]." [13]

If the Committee of governmental experts were to investigate their respective national laws, they might find that anti-subrogation rules do *not* prohibit subrogation against the insured for reimbursement or salvage. The reason is that the rationale behind the anti-subrogation rule – to prevent the insurer from passing the loss back to its insured [14] – does not apply in the case of salvage. Salvage arises only *after* the insured has received the full loss payment. Conversely, the rationale behind subrogation, which is to prevent the insured "from receiving a windfall," [15] is precisely the same as for salvage: to prevent unjust enrichment of the insured. In any event, the very purpose of the revised preliminary draft Protocol is to overcome the differences in national laws and to ensure a uniform approach.

(d) Subrogation for Revenue Salvage preserves the *status quo*

It has been argued that the proposed subrogation clause would give insurers a security interest in the satellite they do not have to-day. That may be true but the insurers have protections under current law which the revised preliminary draft Protocol would effectively extinguish. For example, in many United States jurisdictions, salvage is held in "constructive trust" by the insured for the insurers and is protected from the rights of creditors. [16] Under the revised preliminary draft Protocol, the insurers' trust interest would be an "unregistered interest" in the satellite asset and left unprotected.

Insurers seek merely to secure the *status quo* in the face of a uniform, universal registration system to be established by the future Protocol, which dispenses with some of the key protections found in national registration systems with respect to unregistered interests.

(e) Priorities *would be disturbed if insurers* became registering creditors in their own right

It has been argued that the subrogation clause would disturb the priority of international interests in a space asset and would create complications for inter-creditor agreements. The proposed subrogation clause merely allows the insurer who has paid an insurance claim in full to

---

pays a mortgagee for loss under a fire insurance policy while denying liability to the mortgagor or owner is subrogated to all the rights of the mortgagee and is entitled to an assignment and transfer of the mortgage.") (*citing Tolar v. Bankers Trust Savings & Loan Ass'n.,* 363 So. 2d 732 (Miss. 1978)); *In re SPG of Schenectady, Inc*., 833 F.2d 413, 418 (2d Cir. 1987) (same). *See also* 44A Am. Jur. 2d *Insurance* § 1807 (1982) (stating the general rule that an insurer after paying proceeds to a creditor under a mortgage clause does not have subrogation rights).

[13] *GE Canada Equipment Financing G.P. v. ING Insurance Co. of Canada*, [2009], 94 O.R. 3d 321, 335 (Ont. C.A) (*quoting David Polowin Real Estate Ltd. v. Dominion of Canada General Ins. Co*, [2005], 76 O.R. 3d 161, 186 (Ont. C.A.)).

[14] *See, e.g., Reliance Ins. Co. v. Chitwood,,* 433 F.3d 660, 663 (8th Cir. 2006) ("The anti-subrogation rule prevents an insurer from passing its loss to the insured, thereby avoiding coverage for the very risk for which it accepted premiums, and it prevents insurers from having a conflict of interest that might deprive an insured of a vigorous defence.") (*citing* 16 Couch on Ins. § 224:3 (3rd ed. 2003) and *N. Star Reins. Corp. v. Continental Ins. Co.,* 82 N.Y.2d 281, 294-5 (N.Y. 1993)).*See also DeHerrera*, 219 P.3d at 351 (same).

[15] Robert H. Jerry & Douglas H. Richmond, UNDERSTANDING INSURANCE LAW (4th ed. 2007), § 96(a).

[16] *See, e.g., Luke Hart & Others v. The Western RR Corp.,* 54 Mass. 99, 107 (Sup. Ct. Mass. 1847) (*citing Randal* v. *Cockran*, 1 Ves. sen. 98) (salvage held in trust); *Consolidated Indemnity & Ins. Co.* 38 N.E.2d 119, 120-21 (N.Y. 1941) (a relationship of trustee and *cestui que* trust) (*citing Pink* v. *American Surety Co.*, 283 N. Y. 290, 296 (N.Y. 1940)); *Superintendent Of Insurance Of The State Of New York As Liquidator Of Union Indemnity Insurance Company Of New York v. Baker & Hostetler*, 668 F. Supp. 1057, 1060-1 (N.D. Ohio 1986) (constructive trust); *In re Midland Ins. Co*., 569 N.Y.S.2d 951, 965 (N.Y. App. Div. 1991); (*citing Consolidated Indem. & Ins. Co*., 287 NY 34 (N.Y. 1941). (trust relationship)); 16[1] 12-11 Mealey's Litigation Report: Insurance Insolvency November 2, 2000 (trust); 14-105 Appleman on Insurance § 105.10 [2010] (trust) (*citing Pink v. American Sur. Co. of New York*, 28 N.E.2d 482, at 484 (N.Y. 1940)*, aff'd,* 12 N.Y.S.2d 998*, reh'g denied,* 14 N.Y.S.2d 282.)

"step into the shoes" of the creditor that has been paid off. The insurer's subrogation rights apply only to the extent of the salvage interest. The insurer obtains no greater rights than the creditor-subrogor with respect to any remaining creditors.

Failure to protect Revenue Salvage in the revised preliminary draft Protocol may lead insurers to change the way they write satellite insurance. For example, they may no longer be able to continue the practice of low constructive total loss thresholds and agreed-value policies (where the insurers pay the full sum insured without adjusting for depreciation), a practice creditors value.