INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW
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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
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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 and C.G.E./Space Pr./5/W.P. 7 Add. 1, the UNIDROIT Secretariat received additional comments from the Government of the United States of America. This paper reproduces these additional comments hereunder.

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COMMENTS AND PROPOSALS SUBMITTED BY GOVERNMENTS

United States of America

Revenue salvage – significant problems

I. Summary and Conclusions

(a) Subrogation approach.

The "subrogation" approach to revenue salvage currently under discussion would provide property insurers with a security interest constituting an international interest without the necessity on the part of the insurers actually to document and negotiate the terms of a security agreement

and register an international interest, which would be a significant change in the way in which interests are dealt with under the Protocol system. If parties to actual transactions do not accept this structure to-day, it seems unlikely that they will accept a default provision in the revised preliminary draft Protocol aimed to accomplish the same result, however complete or detailed such a provision might be.

As discussed in more detail below, we believe that the issues created by a "subrogation" approach to revenue salvage cannot be successfully dealt with in a treaty instrument. The approach under discussion is not a classic subrogation and involves numerous substantive and complex issues that will require negotiation by the parties to a particular transaction. As a practical matter, we believe it likely that a Protocol provision on this subject will be overridden and replaced with much more complex and tailored provisions in actual transactions, which adds further costs and complexity to such transactions, inconsistent with the purposes of the planned Protocol. A Protocol provision will, therefore, provide little actual protection to property insurers concerned with salvage issues.

(b) Alternatives

We suggest that, rather than attempting to work with the subrogation approach, which has met with significant opposition among space financing interests, our efforts would be better directed towards addressing more directly the concern expressed to provide a mechanism to protect revenue salvage interests in the revised preliminary draft Protocol. Given the complexity of this issue and the difficulties of negotiating complex alternatives at the forthcoming session and in the space finance community, we recommend an approach which preserves the *status quo* under current national laws (*or other approaches drawing on existing Convention provisions*), does not require extensive consideration at the forthcoming session and would be likely to be accepted in the space finance community.

II. Discussion of the "subrogation" approach

(a) The insured's loan after "subrogation"

Normally, a person (the subrogee) who is subrogated to the rights of a creditor (the subrogor) acquires an equitable assignment of the creditor's rights against the debtor and the debtor's property (here a space asset). As we understand the position of the insurers, their concern is only with finding a mechanism that will permit the registration of any revenue salvage interest they may acquire under national law. The insurer's acquisition of the creditor's rights against the debtor and the space asset upon payment of casualty insurance proceeds to a creditor would be inconsistent with the desired outcome. Rather, the insured's monetary obligations to the insurer should be defined by, and limited to its salvage obligations to the insurer as provided in the insurance contract and under the applicable law. Based on the typical documents that have been provided to us by insurance counsel (attached to this document as Appendix A), the obligation of the insured to the insurer appears to be in the nature of an obligation to turn over a specified percentage of the proceeds of receivables. The documentation also refers to an alternative turnover obligation with respect to "goods and services." In substance, the insurer is not being "subrogated" to the creditor's loan, which remains outstanding, but rather the creditor's loan is being *replaced* by a limited and defined reimbursement obligation of the insured to the insurer. Any such change of the obligation from a loan repayment obligation to a performance-type obligation would need to be accompanied by changes agreed by the parties in many other provisions of the transaction documents suitable to a secured loan, including events of default, covenants and remedies, further discussed below.

(b) Collateral

Through the normal application of subrogation principles, a subrogor would succeed to the creditor's international interest in the space asset. The casualty insurers, however, do not seek such an interest to secure the insured's reimbursement obligations under the policy. (Indeed, the revised preliminary draft Protocol as written provides a method whereby the insurers could acquire an international interest to secure the reimbursement obligation directly, by taking a security agreement.) If the insured's obligations to the insurer are to be collateralised through the "subrogation" approach, presumably the collateral previously securing the creditor's loan would need to be redefined so as to be limited to the percentage of receivables specified in the insurance contract, such as 10%, and the balance of the former secured creditor's collateral released and discharged of record. This means that, if the creditor has not recorded a rights assignment, the creditor's entire registration would need to be discharged and the "subrogation" would not have any effect.

Moreover, as we understand the situation, national laws differ as to whether an insurer's right to revenue salvage is secured (or otherwise gives rise to a property interest) and, if so, the nature of the property in which the insurer acquires an interest. Thus it is not clear whether the newly defined collateral should consist of an interest in the receivables themselves, in the contracts giving rise to the receivables, in the payments arising from the receivables or in some combination of these property interests. Many covenants relative to payment of a secured loan and other covenants and events of default would need to be changed. *Quaere*, for example, the right of the insurer, as subrogee with a 10% interest, to control collection actions with respect to the contracts giving rise to the receivables, or amendments or workouts of those contracts if in default? None of these questions, or many others, are answered by a reference to the "salvage interest" of the property insurer, inasmuch as those interests do not necessarily contemplate a secured transaction.

(c) Conditions to "subrogation"

As is the case under equitable principles, "subrogation" should not be permitted under the revised preliminary draft Protocol unless the creditor's secured debt is paid in full. If the collateral is held by a collateral agent, which is common, and if there are other creditors secured under the common lien which are not paid in full, then "subrogation" should be only to the rights held by the particular creditor that has been paid in full, subject to the limitations and modifications described in the preceding two paragraphs. Because the insurer's secured obligation does not have the characteristics of the creditor's loan, such as a stated principal amount and maturity date, the relative voting rights as expressed in the common security agreement are unlikely to work without an amendment to the credit agreement, which would require the consent of all interested parties. If there are multiple insurers the relative voting rights of each would need to be provided for. If there are unpaid junior secured creditors under the common security agreement, the insurer would be bound by all the provisions contained in that agreement which the insurer does not hold the voting power to change. This would include the priority for distributions to junior secured creditors parties to the common security agreement.

(d) Definition and determination of salvage interests

Because the scope and content of salvage rights may not be clear in any jurisdiction and may vary among jurisdictions, the "subrogation" rights under discussion, which are limited to salvage rights, are likely to be unclear, thereby creating considerable confusion in financings. This is unlike the problem faced by financiers in trying to determine the state of title to a Convention object, because

even upon inquiry and examination of relevant insurance documents the scope and content of the salvage rights cannot easily be ascertained. In particular, the insurance documents do not disclose any equitable lien that might secure the salvage rights. We are not aware of any authoritative summary of salvage rights within the different jurisdictions within the United States of America and doubt that this information is readily available to financing parties in other countries.

(e) Application to leasing

In a leasing structure the whole concept of succession by subrogation to the position of a lessor of a space asset, but limited to salvage rights having to do with a turnover of a portion of contract receivables, is difficult to conceive. The contracts generating receivables are typically with the operator/lessee and not with the insured lessor. Upon a casualty occurrence the lease typically must be paid off and the leased property conveyed back to the lessee/operator, thereby terminating the lease and depriving the lessor of any interest in the receivables to which the insurer could be subrogated. Inasmuch as revenue salvage is an alternative to title salvage (see paragraph (f) below), revenue salvage would not arise if the lessor's ownership and leasehold interest were transferred to the insurer by "subrogation."

(f) No duplication

If a "subrogation" approach to salvage interests is contemplated, salvage interests provided under the applicable law should be excluded in order to avoid duplication and confusion. If the insurer is to be turned into a secured creditor by these provisions with respect to a portion of the insured's receivables, then it should not also hold other and perhaps conflicting rights and remedies with respect to those same receivables under national law. For example, if the receivables are considered to be held under a constructive trust or an equitable lien in a jurisdiction, it would not be desirable for them also to be considered pledged under a rights assignment under the revised preliminary draft Protocol. The confusion of rights and remedies that would result would be unacceptable to financing parties and to the insureds.

Moreover, we are informed that, from the insurer's perspective, revenue salvage and title salvage are alternatives. If the revised preliminary draft Protocol were to provide for both the registration of title salvage and "subrogation" with respect to revenue salvage, additional provisions would be needed to insure that both are not exercised and that any unexercised title salvage is discharged of record.

APPENDIX

THE SALVAGE CLAUSE

"Satellite insurance policies customarily include a salvage clause among the policy conditions. The clause typically provides that upon payment of the insurance proceeds following a loss, insurers are entitled to salvage. The policy may provide for Satellite Title Salvage and Satellite Revenue Salvage in the following manner:

Upon payment of a Total Loss or a Constructive Total Loss, the Insured agrees to transfer title to the affected satellite to the Insurers, upon Insurer's request.. .The Insurer shall be deemed to have waived its right to request the transfer of title if it has not been requested within six months following the payment of such loss.

In the event the Insurer pays a claim under this Policy and in the event that the Insured subsequently derives revenue from the operation of the failed satellite, or a failed portion thereof, the Insurer will be entitled to the recovery of such payment by the return of a [a specified amount, e.g., 10% or the full amount of the claim paid] of the gross revenue earned, or equivalent in goods and services derived, from the operation of the failed satellite. . .

Following payment for the partial loss by the Insurer, the Insured shall use reasonable efforts to obtain the maximum benefit of salvage, on that portion of the satellite for which a claim has been paid, for Insurers. . . "

Excerpt from *The Cape Town Convention, Space Protocol: The Need to Include Insurers' Salvage Interests*, by Zuckert Scoutt & Rasenberger, L.L.P., on behalf of Leading Space Insurers, 8 October 2007, page 3.