

An Overview of the Protocol on Space Assets from China's Perspective

*Jilian Wang**

With the development of space technology, space activities have become more and more commercialized. Since space activities go beyond national boundaries into outer space and have high demand for capital, the players in space financing have to assume great risks as they seek to earn profits. Therefore, it becomes a major issue of common concern for space and related sectors to establish an effective international regimen governing space financing. To facilitate international financing and leasing based on high-value mobile equipment including space assets, the International Institute for the Unification of Private Law (UNIDROIT) organized the formulation of the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Space Assets (hereinafter referred to as the Space Protocol), which was adopted and opened to signature at a Diplomatic Conference held in Berlin from 27 February to 9 March 2012. Chinese space industry is extending itself to various fields of international commercial space sector and increasing its shares in global space market. China wishes to see its interests to be recognized and protected by international rules both as the creditor and the debtor in the international space assets-based financing activities. The Space Protocol, designed to address issues related to space assets-based financing, will have major impact on China, including its banking, insurance sectors and current legal regime as well as the space industry. The Space Protocol is thus of great importance to China both theoretically and practically. Therefore, it is urgent for China not only to study the instrument itself, but also to conduct further research and analysis on whether and when to accede to the Space Protocol. Such choice should be made by taking account of the possible implications for related national sectors as well as ramifications for our national interests and current legal regime.

As space technology advances and more satellites are constructed and launched for civil telecommunications, remote sensing and navigation purposes, the commercial sector is increasingly involved in space activities and has been providing much-needed private financing in addition to investment by governments. Since space activities cross borders while on Earth, may take place in outer space and have huge demand for capital, the parties in space financing have to

* China Great Wall Industry Corporation, China, wangjl@cgwic.com.

assume great risks as they seek to earn profits. Therefore, it becomes a major issue of common concern for space and related sectors to establish an effective international regimen governing space financing.

I. Background

In order to facilitate transnational financing and leasing of high value mobile equipment, the International Institute for the Unification of Private Law (UNIDROIT) has been preparing for more than two decades a comprehensive international treaty regime that includes the Convention on International Interests in Mobile Equipment and its equipment specific Protocols (namely for aircraft, railway rolling stock and space assets). UNIDROIT adopts this two-instrument approach of formulating a base convention and supplementing and modifying it by protocols for certain categories of objects so as to reflect particular need of specific industry sector. It is stipulated expressly in the Convention that the Convention and the Protocol shall be read and interpreted together as a single instrument and that to the extent of any inconsistency between the Convention and the Protocol, the Protocol shall prevail. The Convention, to which China is a contracting party, was adopted at a Diplomatic Conference held in Cape Town, South Africa in 2001 and came into force in 2004.

UNIDROIT had been engaging itself in preparation of a draft protocol for space assets to the Convention since 1997 with participation of government sector, satellite manufacturers/operators and finance experts. For this purpose, the UNIDROIT Committee of governmental experts for the preparation of a draft Protocol to the Convention (hereinafter the Committee of governmental experts) was convened in five sessions, all of which Chinese representatives attended to share their views and positions. The text of the draft Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Space Assets (hereinafter referred to as the Space Protocol) as established following the fifth session of the Committee of governmental experts was adopted by a Diplomatic Conference held in Berlin from 27 February to 9 March 2012 and then opened for signature.

II. The Convention and the Space Protocol

As the primary objective of the Convention and the Space Protocol is to stimulate and facilitate space assets financing, the major concern to be addressed therein is how to protect rights and interests of creditors in financing transactions. The Convention introduces the term of “international interests” to refer to such interests as covered by this treaty regime. According to the Convention, “creditor” means a chargee under a security agreement, a conditional seller under a title reservation agreement or a lessor under a leasing agreement. An “international interest” means an interest of such a chargee, conditional seller or lessor in a uniquely identifiable object that is constituted by a written security agreement, title reservation agreement or leasing agreement. International

interests in space assets thus refer to interests of rights holders in identifiable space assets designated in the Space Protocol.

Since international interests are in nature non-possessory *in rem* rights, the Convention and the Space Protocol establish the international registration system to reduce uncertainty in enforcing creditors' rights. Registration gives public notice of interests registered by holders in the designated registry in accordance with the Convention and this Protocol, which also contain provisions on priorities and default remedies.

The general priority rule relating to international interest is that a registered interest has priority over a subsequently registered interest and over an unregistered interest. Duly created international interests shall have effects against third parties upon registration, which means that in the event of the debtor's default, the creditor is entitled to assert priority of compensation in relation to its registered interest against any subsequently registered interest or unregistered interest.

The central purpose of international registration system and priority rules as provided in the Convention is to ensure readily enforceable default remedies for creditors. To protect holders of international interests, the Convention and the Space Protocol set out detailed remedies in the event of the debtor's default, which include remedies of a chargee, remedies of a conditional seller or lessor, relief pending final determination and remedies on insolvency. A creditor who adduces evidence of default by the debtor may, pending final determination of its claim and to the extent that the debtor has at any time so agreed, obtain from a court speedy relief in the form of an order for preservation of the object or its value, possession, control or custody of the object, immobilization of the object or lease or management of the object and the income therefrom. In insolvency proceedings against the debtor an international interest is effective if prior to the commencement of the insolvency proceedings that interest was registered in conformity with this Convention. As space assets may affect certain interests of contracting states, the Space Protocol imposes restrictions on remedies such as public service limitations, limitations for national security or export control concerns and restrictions in respect of physically linked assets. The regimen established in the Convention and the Space Protocol governing international interests in space assets helps to enhance creditors' confidence in asset-based financing and thus renders it less expensive and more accessible to the space industry.

To accommodate distinctive features of space financing, the Space Protocol contain many specific rules that are not found in the Convention or earlier Protocols. For example, financing forms provided in the Convention are mostly based on assets that are directly pledged as security. However, space assets, notably satellites, are different from aircraft or railway rolling stock due to the impracticability of repossession, especially while in outer space. For this reason this Protocol contains "rights assignment" provisions by which the debtor can assign its claims against third parties ("debtor's rights") to the creditor for the purpose of financing. In this way, the financier who has taken an international interest in the space assets in course of transactions with the satellite operator is

given additional collateral in the form of revenue derived from satellite service. In case of the satellite operator's default, the financier may stand in its shoes to claim such revenue directly against satellite users without any interruption to the satellite operation.

Regulations specific to space assets in the Space Protocol also include: (1) definition and identification of space assets; (2) formalities, effects and registration of contracts of sale; (3) default remedies in relation to rights assignment and rights reassignment, remedies on insolvency, insolvency assistance and limitation on remedies in respect of public service; (4) broader interpretation of "exercise of remedy in a commercially reasonable manner", and (5) prohibition of enforcement of an international interest in a space asset that is physically linked with another space asset.

III. Implications for Related Domestic Sectors

It is envisaged that accession to the Space Protocol would have significant impact on China, including its space industry, banking sector, insurance sector and the existing legal regime.

Space Industry

China had already begun its space research before the launch of mankind's first artificial satellite. Recent decades have been witnessing rapid progress of China's space industry, investment in which has now risen to 4% of the nation's GNP.

Space program needs to be supported by a considerable amount of capital. It costs billions of RMB to build a communications satellite system, which will not pay back in short term. To meet the huge capital demand, foreign satellite operators are resorting to multi-source financing, inter-company cooperation or joint venture. For instance, Intelsat has developed several "Horizon" satellites in cooperation with Sky Perfect Jsat of Japan and is developing a new satellite that covers Europe in cooperation with Telenor of Norway.

According to *Space Report 2011* released by the Space Foundation, there were an estimated 957 active satellites in orbit around Earth as of the end of 2010. In 2011, a total of 83 launches were conducted, bringing around 121 spacecraft into orbit for operation. However, since use of orbit/spectrum resources by the satellite systems is predicted to reach its peak in 2015, the current decade will see a greater number of launches. For example, such demand has been boosting for building satellite navigation systems, with updating of US's GPS as well as developing of Europe's GALILEO, Russia's GLONASS and China's BeiDou. *Research Report-Satellites to be Built and Launched by 2019* published by Euroconsult estimates that during 2010s, 1229 satellites will be manufactured and launched globally and the generated revenue will amount to 195 billion USD, up by 59% and 50% respectively over the last decade.

Facing with fierce competition, China looks to increase its global market share in commercial satellite to 10 percent and share in commercial space launch to

15 percent by the end of 2015. As achievement of these goals depend heavily on sufficient supply of capital, it is essential for China to put in place a legal regime that promotes commercial space financing.

Banking Sector

With increased involvement of commercial sector in space activities, banks are now becoming an important player in financing research and development, manufacture and purchase of space products. Given the high risks in space finance, the common practice now is for several banks to jointly finance a space program. Banks usually require that such loans be secured to ensure repayment by the borrower. Currently, it is major international banks that are taking an active part in space finance. Chinese banks with little experience in satellite finance in the past are expected to expand their practice in space assets financing in the thriving commercial satellite market.

The Space Protocol establishes a uniform regimen to protect rights and interests of banks as creditors in space assets financing and increases the level of transparency and predictability, thereby making it more attractive for banks to engage in space finance. While this Protocol provides for remedies for creditors in the event of debtors' default, it also places restrictions on exercise of such remedies to address sovereignty and public interests concerns. Banks are thus strongly advised to pay due attention to elements of ambiguity to minimize risks in practice and are expected to come up with more effective solutions.

Insurance Sector

China entered the international commercial launch market in early 1990s, when domestic insurers had barely started any aviation insurance practice, let alone space insurance. As a result, no insurance was purchased for the first four launches of satellites, including AsiaSat-1 and three Australian satellites. In respect of any third party liability, government-backed guarantee is provided in line with applicable international conventions. To help its space industry shift to commercial insurance, China set up the China Space Insurance Pool as a policy/non-commercial insurer led by the People's Insurance Company of China (PICC). The first purely commercial space insurance was the launch insurance for FY-2C Satellite in 2004, provided by a union of five commercial insurers, namely China Pacific Property Insurance, Ping An Property Insurance, BOC Insurance, China United Property Insurance and Tianan Insurance. The insured amount of this launch insurance totaled 395 million RMB, of which 20.75% was in retention and 79.25% was ceded to reinsurers abroad. In 2006, the launch insurance for FY-2D Satellite was provided by a union of 14 domestic insurers with retention accounting for 30% of the total insured amount. The growing number of insurers and percentage of retention indicate a growing interest among domestic insurance sector in space insurance.

Initially, although drafters of the Space Protocol made every effort to provide full protection for insurers in space finance dealings based on salvage interests, their worries were still unfortunately hard to be assuaged. Later, a representative from the international insurance sector proposed that all provisions re-

garding salvage interests be removed and replaced by a single and simple clause that reads, “Nothing in the Convention or this Protocol affects any legal or contractual rights of an insurer to salvage recognized by the applicable law.” This proposal was accepted at the Berlin Diplomatic Conference and thus incorporated into the final text of the Space Protocol. This means that as long as insurers enjoy legal or contractual rights to salvage under applicable law, such legal or contractual rights shall enjoy priority over subsequently registered ownership or any other rights and interests of the chargee or assignee, irrespective of the fact that neither is the insurer defined as the creditor, nor does salvage constitute international interest under the Convention.

Domestic Legal Regime

Since the Convention and the Space Protocol are primarily concerned with protecting rights and interests of the chargee, conditional seller or lessor as defined therein, China’s accession would make it necessary to adjust its domestic legal system in certain aspects in conformity with the Convention and the Space Protocol, including jurisdiction, immunity, coherence in related laws such as Real Right Law, Guarantee Law, Banking Law, Law on Commercial Banks, Insurance Law, Enterprise Bankruptcy Law, Law on Guarding State Secrets, National Security Law and a prospective Space Law.

One of such examples is relation between registration under China’s Guarantee Law and international registration system in the Space Protocol. Article 54 of the Guarantee Law stipulates that where the same property is mortgaged to two or more creditors through registration, liquidation shall be made in order of time of registration. Registration here shall be made in domestic registry, while the Space Protocol recognizes only international interests registered in the International Registry to be established in accordance with the Convention and this Protocol. Therefore, China’s accession to the Space Protocol might result in conflict in application of rules and burden of “double registration”.

Another example is Article 37 of the Guarantee Law, which forbids such properties to be mortgaged as educational facilities, medical and health facilities of schools, kindergartens, hospitals and other institutions or public organizations established in the interest of the public and other facilities in the service of public welfare. This means that properties set forth above that can be identified as space assets still cannot be mortgaged in the manner as prescribed in the Convention.

Besides, it is worth noting that application of the Convention and the Space Protocol is conditioned only on the debtor being situated in a Contracting State. The fact that the creditor is situated in a non-Contracting State does not affect the applicability of this Convention. Consequently, national entities taking part in international transactions as creditors shall prepare for application of the Space Protocol even if China has not become a contracting state.

IV. Conclusion

In order to achieve the principal objective of facilitating space finance, the Convention and the Space Protocol establish elaborate rules and systems centering on international interests in seeking to secure creditors' rights and interests. Such protection will build creditors' confidence in providing capital, reduce the cost of financing and thus help debtors benefit from boosted space finance market. In this sense, accession to the Space Protocol is conducive to development in related domestic sectors, either as creditors or as debtors.

However, many provisions in the Convention and this Protocol that are specific to space assets are yet to be tested in practice. It is uncertain whether they can be proven as successful as those in the Aircraft Protocol, since aircraft and space assets fall into different categories of mobile equipment. In conclusion, China needs to remain both active and cautious in deciding whether and when to accede to the Space Protocol. While continuing with comprehensive studies on this instrument and its implications, it shall take into account concerns of all interested parties in making decisions regarding China's accession to the Space Protocol.