

# Reconceptualizing Lender Liability for Satellite Projects

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## 1. Introduction

In 1975, Douglas-Hamilton cautioned that “whenever a creditor contemplates taking a hand in the management of a financially troubled debtor, it should think of its deeper pockets and keep its hands there.”<sup>1</sup> Her prescient remark went unheeded. As a result, ‘lender liability’ litigation has kept lawyers busy and courtrooms packed. Yet Douglas-Hamilton’s words ring true today – and especially, as I argue in this paper, for those lenders that finance satellite projects.

## 2. Roadmap

I have structured this paper as follows. In Section 3, I describe and reconceptualize lender liability by presenting two broad categorizations for how this liability arises. These categorizations are *reliance* and *control*. In Section 4, I then explore the specific features of satellite financing that magnify lender liability risk. A risk management discussion then follows in Section 5, in which I link satellite financing’s specific features to the reliance and control categorizations of lender liability. Section 6 concludes.

But first, some caveats. Satellite projects are highly complex – as are satellite financing transactions. Further, lender liability claims are highly fact-specific. These attributes mean that this paper, brief as it is, cannot provide a complete treatment of this subject. In particular, I do not focus on any specific national legal system in this paper. Nor will I elaborate on the existing lender liability case law. In addition, issues regarding cross-waivers of liability – common as they are across the space industry – are only briefly addressed in Section 5.

These exclusions arise because my purpose in writing this paper is not *solely* to guide lenders. Indeed, the practical, ‘cash value’ of this paper is limited. The standard view of lenders as having ‘deep pockets’ – that is, ample funds –

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1 Margaret Hambrecht Douglas-Hamilton, “Creditor Liabilities Resulting from Improper Interference with the Management of a Financially Troubled Debtor” (1975) 31:1 *Bus Law* 343-365 at 365.

makes them attractive targets for litigation. And clever lawyers will invariably develop novel grounds for pursuing claims against lenders. Instead, these exclusions create room for discussion; to explore the how and why of lender liability for satellite projects. This discussion also involves considering how the legislative imposition of lender liability could help solve a pressing issue that we face in space today: orbital debris. I return to this topic in Section 6.

### 3. Lender Liability

Diverse legal theories underpin lender liability claims.<sup>2</sup> Broadly, these claims attempt to attach liability for losses to lenders. Importantly, as Willis explains, they “arise from claims not only by borrowers and depositors, but also by third parties and governmental entities.”<sup>3</sup>

Despite this diversity, I posit that it is possible – and, more importantly, that it is useful – to reconceptualize lender liability as arising due to *reliance* or *control*. More specifically, some lender liability claims argue that a lender rendered a faulty and damaging credit assessment. Other claims involve the (allegedly) overhasty withdrawal of funding. Alternatively, the borrower may simply come to depend on advice from the lender and follow it to the letter. I categorize all these claims as arising due to *reliance* – the borrower’s reliance on the lender to act in a certain way, to provide certain information, and so on.

By contrast, other lender liability claims argue that the lender has stepped into the borrower’s shoes. These claims arise where the lender essentially runs the borrower’s business. In such cases, it is arguable that the borrower has become the lender’s agent or ‘alter ego’. The influence that a lender has over a borrower is also the avenue utilized by national legislatures to impose statutory lender liability. For example, legislation in the United States, the United Kingdom and the People’s Republic of China imposes obligations on lenders relating to environmental damage.<sup>4</sup> The idea behind this is that the lender can pressure borrowers to prevent and remediate environmental damage.<sup>5</sup> I categorize all these claims as arising due to *control* – the lender’s control over the borrower to compel specific actions.

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2 Jeffrey Willis, “The Substantive Law of Lender Liability” (1997) 26:4 *Tort & Ins L J* 742-777 at 742.

3 *Ibid.*

4 See generally Lloyd Andrew Brown, “What’s the Lender Liability Risk for Soil Pollution in the People’s Republic of China? An Evaluation of China’s New Soil Pollution and Control Law in the Light of the USA and UK Regimes” (2019) 21:3 *Env’tl L Rev* 173-188.

5 P. Ishwara Bhat & Sandeepa Bhat, “UNIDROIT System of Asset Based Financing for Space Activities - Need to Plug the Loopholes” (2007) 50 *Proc on L Outer Space* 238-265 at 244.

Reception of reliance- and control-based lender liability claims varies significantly across jurisdictions. For example, an agency relationship may be found based on a lender's right to control rather than actual, demonstrated control. The ability of an agent to bind in contract can also be determinative. And, of course, environmental lender liability – while still based on notions of control – is entirely reliant on the specifics of a jurisdiction's statute book. Despite these variations, there are sufficient commonalities underpinning lender liability claims to enable a general, non-jurisdiction specific treatment of the subject.

#### **4. Magnifying Factors**

There are three factors that magnify lender liability risk in the satellite financing context. The first factor is *distance* – that is, the nature of satellites as orbiting objects that lenders cannot physically inspect or repossess. The second factor is *quantum* – the sheer size of the potential damages resulting from launch or orbital mishaps. The third factor is *liability*, arising from the complex, international-national legal regime that governs liability for space activities. I provide further detail for each factor in the following paragraphs.

##### **4.1. Distance**

The inaccessibility of an orbiting satellite motivates lenders to seek the broadest possible security for their loans and impose stringent obligations on borrowers. For example, consider a new market entrant seeking to build, launch and operate a geostationary communications satellite. Such a project would typically be project financed. To secure this funding, a lender will demand a comprehensive security package. This package will include the satellite itself, associated licences and customer contracts, ground stations and equipment, and project company equity. Lenders also impose strict reporting requirements concerning the satellite's health, alongside satellite utilization restrictions.

A lender is motivated to impose these requirements and take such a broad security package to ensure repayment in the event of default. But the security package's breadth, and the obligations imposed on borrowers, may present unforeseen risks to lenders. This is because these arrangements result in the lender having significant influence over the project – and there is often a fine line between influence and control.

##### **4.2. Quantum**

Space is a capital intensive and unforgiving operational environment. The losses that may arise from satellite projects are significant. Seemingly minor events can (and do) result in deep losses. These can easily run to the hundreds of millions of dollars for the loss of a satellite alone. However, as Smith

explains, the loss of a satellite is just “one aspect of [the] resulting damage”.<sup>6</sup> This is because a satellite may collide with other space-based assets. Such an event could “lead to massive (physical, material and economic) damage occurring in orbit, with potential for further consequential loss on earth.”<sup>7</sup> In an extreme case, a satellite mishap could trigger a ‘Kessler syndrome’-event.<sup>8</sup> The losses arising in such a scenario would be staggering.

### 4.3. Liability

On the international plane, States face unlimited liability for space activities.<sup>9</sup> This unbounded liability compels many States to impose insurance and indemnification requirements on their nationals’ space activities. Hurwitz attributes the imposition of mandatory insurance to “the existence of bankruptcy laws” which “force governments to see to it that private enterprises will ... obtain proper insurance for their outer space activities.”<sup>10</sup> In the absence of insurance, private enterprises could simply declare bankruptcy to “absolve themselves from the necessity of compensating persons suffering injury or damage as a result of their [space] activities.”<sup>11</sup> The relevant government will usually be named as co-insured in the policy. However, there is no such thing as the perfect insurance policy: all policies have limits, and often have extensive exclusions. Accordingly, States also impose indemnification requirements. Dempsey canvasses how Belgian, Dutch, Swedish, Japanese, Italian, Russian and British laws provide legal mechanisms for recovering compensation paid at the international level from persons involved in the relevant space activities.<sup>12</sup> He also mentions the Outer Space Ordinance (Cap. 523 of the Laws of Hong Kong). This legislation is admirably clear on the indemnification point:

[a] person who carries on an activity to which this Ordinance applies shall indemnify the [Hong Kong] Government and the Central People’s Government [in Beijing] against any claims brought against either government in respect of damage or loss arising out of such activity carried on by [that person].<sup>13</sup>

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6 Lesley Jane Smith, “Facing Up to Third Party Liability for Space Activities: Some Reflections” (2009) 52 *Proc Int’l Inst Space L* 255-263 at 257.

7 *Ibid.*

8 That is, a situation where cascading collisions occur between space objects, thereby precipitating further collisions.

9 Bruce A Hurwitz, “Liability for Private Commercial Activities in Outer Space” (1990) 33 *Proc on L Outer Space* 37-41 at 166.

10 *Ibid* at 37.

11 *Ibid.*

12 Paul S Dempsey, “Liability for Damage Caused by Space Objects under International and National Law” (2011) 54 *Proc Int’l Inst Space L* 165-175 at 170-171.

13 Section 12(1).

Section 3 provides that the Outer Space Ordinance applies to “launching or procuring the launch of a space object ... operating a space object ... [or] ... any activity in outer space.” I have previously commented that financing a launch, in and of itself, is unlikely to constitute an activity to which the Outer Space Ordinance applies under Hong Kong law.<sup>14</sup> However, this will depend on the lender playing a purely financial role. Such a limited role is not always the case in practice. In addition, the dual international-national nature of this liability regime means that private persons suffering loss have multiple, non-exclusive pathways by which to recover.<sup>15</sup> Indeed, as Smith notes, third party losses are more likely to be pursued “before national courts, especially in the case of commercial space operations.”<sup>16</sup> Overall, this complex liability regime makes accurate exposure assessments difficult.

## 5. Risk Management

Due to these magnifying factors, a lender will typically take a comprehensive security package for a satellite financing. After all, the potential losses are significant – and there is a complex and unlimited liability regime in place for space activities. States bear this liability at the international level. Nonetheless, a lender’s perceived deep pockets will be attractive targets for recovery by governments and third parties. So how can lenders manage this magnified lender liability risk? In this Section 5, I share some preliminary thoughts on this crucial question.

Before proceeding further, I should address cross-waivers. Participants to space ventures typically agree to cross-waivers of liability, whereby each participant assumes responsibility for damage to their property and personnel. In most cases, participants are held harmless from claims from other participants. However, these cross-waivers will not necessarily preclude governments from recovering sums paid as compensation under international law from private entities.<sup>17</sup>

The indicia for when a lender liability claim may resonate with a court or tribunal will vary across jurisdictions. And within jurisdictions, the various lender liability theories cannot be applied using bright-line rules. They are highly context-sensitive. And specific actions may become necessary following an event of default. Standard lender liability risk management measures include due diligence and careful contractual drafting, combined with lender liability insurance. But, at a general level, I have identified the following elements as requiring further attention:

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14 Jack Wright Nelson, “A Practitioner’s Guide to Hong Kong’s Outer Space Ordinance” (2019) 68:3 *German J Air and Space L* 387–411 at 399.

15 Dempsey, “Liability for Damage Caused by Space Objects”, *supra* note 12 at 166.

16 Smith, “Facing Up to Third Party Liability”, *supra* note 6 at 255.

17 *Ibid* at 258.

- (1) A lender should be wary when giving advice. Advice is a particular challenge in the satellite industry. This is because of the relatively small number of lenders in the market and the strict confidentiality obligations that permeate the space industry. The market's relatively small and opaque nature leads borrower-operators to ask advice from experienced lenders, who often have a rare, 'bird's eye' view.

Nonetheless, a lender should limit themselves to periodic recommendations or suggestions to the borrower-operator. At no point should a lender direct that a borrower-operator adopt any specific recommendation or suggestion.

- (2) Veto powers over the actions of borrower-operators should be constrained and clearly articulated. Any veto power should not be so broadly drafted that the lender can veto a borrower-operator's daily business decisions.

But where to draw the line here? For example, should a lender have the right to veto the appointment of a telemetry, command and control (TT&C) provider? Such a right is common in satellite financing documents. But such a veto may be construed as permitting the lender to steer the borrower-operator toward a particular TT&C provider. This issue would arise following a satellite mishap caused by the TT&C provider's negligence or error.

For this reason, the way veto powers are exercised is also essential. As Willis notes, "[i]n addition to exposure to claims by the [borrower], excessive interference and control in the operations of a borrower may subject the lender to liability to third parties who also have business dealings with the [borrower]."<sup>18</sup>

- (3) A lender should avoid becoming involved in the internal, operational matters of the borrower-operator. This situation could arise where, for example, the lender negotiates new transponder leases or engages with the TT&C provider on behalf of the borrower-operator.

Of course, a lender's involvement with a borrower-operator's internal affairs would increase substantially following an event of default. In such circumstances, a lender will generally have various powers to complete and launch the satellite (for a satellite pending launch) or issue instructions to the TT&C provider (for an orbiting satellite). Willis relevantly explains that lender liability claims are more likely to arise where "the lender has gone *beyond the specific rights granted by loan documents* ... even though such action is almost always motivated by the understandable desire to protect

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18 Willis, "Lender Liability", *supra* note 2 at 753.

collateral or ensure repayment.”<sup>19</sup> Lenders should keep this in mind as borrower-operators approach default.

## 6. Conclusions

The tentative conclusions that I have reached in this paper are as follows:

- (1) The various theories of lender liability can be broadly categorized as based on reliance or control.
- (2) Factors of distance, quantum and liability magnify lender liability risk in the context of satellite projects.
- (3) Lender liability risk can be managed in the satellite context by carefully framing any advice rendered, having clear and constrained veto powers and refraining from operational involvement.

As a final comment, I return to the topic of environmental lender liability. Human activity is rapidly degrading the space environment. Should environmental lender liability be extended to this environment? Bhat and Bhat first raised this issue in 2007. They comment that “[a]s the lenders ... can control the debtor’s venture through the tools of finance,” it is “possible to make lenders liable for environmental damage caused by the space activities [that they finance].”<sup>20</sup> From an environmental and commercial perspective, the orbital debris issue is particularly pressing. To this end, we need to consider the imposition of an environmental lender liability regime specific to orbital debris. This regime could compel lenders to perform enhanced due diligence on – and monitoring of – borrower compliance with debris mitigation standards. This will all cost money; some industry participants may object to the increased borrowing costs. But these increased costs are justified if they better reflect the actual costs of satellite projects, inclusive of negative externalities. Moreover, such measures make sound business sense since unconstrained orbital debris proliferation will destroy the commercial satellite market.

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<sup>19</sup> *Ibid* at 742. My emphasis.

<sup>20</sup> Bhat & Bhat, “Asset Based Financing for Space Activities”, *supra* note 5 at 244.