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Consideration of the draft convention of the International Institute for the Unification of Private Law (Unidroit) on international interests in mobile equipment and the preliminary draft protocol thereto on matters specific to space property

Draft Convention of the International Institute for the Unification of Private Law on international interests in mobile equipment and the preliminary draft protocol thereto on matters specific to space property

Report of the Secretariat and the secretariat of the International Institute for the Unification of Private Law

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I. Introduction

1. At its forty-third session, in 2000, the Committee on the Peaceful Uses of Outer Space agreed on the inclusion of a new single issue/item for discussion in the agenda of the Legal Subcommittee for its fortieth session in 2001, entitled "Consideration of the draft convention of the International Institute for the Unification of Private Law (Unidroit) on international interests in mobile equipment and the preliminary draft protocol thereto on matters specific to space property". The Committee also agreed that the Secretariat and Unidroit should be requested to prepare a report on the convention and space property protocol that would provide background information for discussion of the item by the Legal Subcommittee.¹

2. The present report has been prepared jointly by the Secretariat and the secretariat of Unidroit in response to the above-mentioned request.

II. Proposed new international regime of the International Institute for the Unification of Private Law governing the taking of security in space property

A. Origins

3. The origins of Unidroit's efforts for the preparation of a new international regime governing the taking of security in high-value mobile equipment go back to the adoption of the 1988 Convention on International Financial Leasing.² Article 7 of that Convention includes a rule recognizing the enforceability of the lessor's real rights against the trustee in bankruptcy and unsecured creditors of his lessee. The success of that approach persuaded Unidroit of the desirability of seeking to extend that principle to the enforceability of security rights in those special categories of high-value mobile equipment which, by reason of the fact that they are of a kind likely to be moving across or beyond national frontiers on a regular basis in the ordinary course of business, do not particularly lend themselves to the application of the *lex rei sitae* for the resolution of disputes concerning the validity, enforceability and priority ranking of such rights.

4. This legal rationale was moreover reinforced by economic reasons. The opportunities for asset-based financing of such categories of equipment have to date been extremely limited because of the evident difficulties lenders face in securing and collecting on such loans. The special advantage of asset-based financing for high-value capital equipment resides in the reduction in costs that follows from the reduction in risk for the financier permitted by his ability to have prompt recourse to the value of the underlying asset in the event of default by the debtor. To take the specific example of space property, those private lenders contemplating lending on the security of a satellite are clearly going to want to find out whether other lenders may already also have claims outstanding against that same asset. Currently, there are no reliable mechanisms available to potential lenders for the screening of such outstanding claims. Failing the development of a centralized recording system for the registration of interests in space property, such a mechanism will not be available to potential lenders. Another practical problem that has hitherto tended to restrict opportunities for the use of asset-based financing in respect of space property arises out of the practical complications involved in repossessing property physically located in Earth orbit in the event of the debtor defaulting.

B. Working procedures of the International Institute for the Unification of Private Law and status of work on the project to date

5. It is a peculiarity of Unidroit's working methods that its preparation of international instruments does not involve the immediate convening of governmental experts but that the basis for such intergovernmental negotiations is first sought in the efforts of study groups manned not by representatives of Governments but by the world's foremost experts in the particular field, drawn from the spheres of both law and practice, sitting in their personal capacity. The results of the efforts of those study groups, in the form of preliminary draft instruments, are then submitted to the Governing Council of Unidroit, study groups being emanations of the Council and chaired by a member of the Council. The purpose of the consideration of these preliminary draft instruments by the Council is to

decide whether it is appropriate to authorize their transmission to Governments with a view to the convening of sessions of experts from such Governments to prepare the texts at an inter-governmental level such that they may be capable of being submitted for adoption as international instruments. In the event that the Council decides to authorize the transmission to Governments of a preliminary draft instrument prepared by a study group, it will then be for the Council, at such time as governmental experts have drawn up a draft instrument on the basis of the preliminary draft, to decide whether the draft instrument in question is sufficiently advanced to warrant the convening of a diplomatic conference for its finalization and adoption as an international instrument.

6. At the time when Unidroit work in this area commenced, in 1993, with the first session of a study group, Unidroit's intention was to prepare a single international instrument capable of covering all the different categories of high-value mobile equipment intended to be covered by the future Convention. At the time it was envisaged that this would embrace not only airframes, aircraft engines and helicopters, containers, oil rigs, railway rolling stock, registered ships and space property but also other categories of uniquely identifiable object.³

7. The aircraft industry, representatives of which first became actively involved in the development of the convention in 1994, quickly demonstrated its anxiety to see the future convention enter into force and for it to be able to benefit from its innovations at the earliest possible opportunity. The anxiety on their part was matched by a corresponding reluctance to wait for other industry groups, such as the space industry, to reach the same level of industry consensus as they had achieved regarding the special rules that would be needed to adapt the general rules of the contemplated convention to the special characteristics of each of the different categories of equipment intended to be covered. In 1997, the study group therefore decided to split the future convention into a base convention, carrying the general rules applicable to all the different categories of mobile equipment intended to be covered and separate equipment-specific protocols for each of the different categories, carrying the special rules needed to adapt the general rules of the convention to the special characteristics and requirements of each category of equipment. From that moment on, priority

was given to the completion, as a necessary first stage, of the draft Unidroit convention and a draft protocol thereto on matters specific to aircraft equipment (the "draft aircraft protocol").

8. The draft Unidroit convention (to be issued in a conference room paper) and the draft aircraft protocol have already been the subject of a series of intergovernmental meetings sponsored jointly by Unidroit and the International Civil Aviation Organization (ICAO), by reason of its special competence for matters pertaining to international civil aviation. Those texts are now ready for submission to a diplomatic conference of adoption. It has been decided by the Unidroit Governing Council and the Council of ICAO that such a diplomatic conference is to be held in principle in South Africa in May 2001.

9. This notwithstanding, work has nevertheless been pursued continuously over the period since 1997 on the preparation of two other preliminary draft protocols to the draft Unidroit convention, one on railway rolling stock—the preliminary draft protocol on matters specific to railway rolling stock, prepared by the Rail Working Group, has already been approved by the Unidroit Governing Council for transmission to Governments and is to be the subject of a first session of governmental experts in March 2001—and the other on space property. Work on the preliminary draft protocol has been conducted pursuant to the invitation addressed by the President of Unidroit in 1997 to Peter D. Nsgos (Milbank, Tweed, Hadley & McCloy LLP, New York), one of the world's leading experts in the space finance law field, to organize a working group to prepare, for submission to the Unidroit Governing Council, the text of a preliminary draft protocol on matters specific to space property that could be considered representative of industry consensus.

10. The Space Working Group organized and coordinated by Mr. Nsgos has made considerable progress in the preparation of the preliminary draft protocol and anticipates being in a position to submit a text to the Unidroit Governing Council at its eightieth session, to be held in Rome from 17 to 19 September 2001, with a view to that body authorizing its transmission to Governments and the convening of governmental experts to prepare a draft protocol capable of being submitted for adoption as an international instrument. The Space Working Group

brings together expertise from the different parties to commercial space activities, in particular manufacturers, financiers and operators of space property.

11. With a view not only to addressing the outstanding issues left open in the current working draft of the protocol but also to making a preliminary examination of the issues that merit consideration in the context of the relationship between the proposed new international regime for space property and the existing body of space law, Unidroit convened a meeting of an ad hoc restricted informal group of experts in Rome on 18 and 19 October 2000. The meeting was structured in an original way for Unidroit, given the fact that the Unidroit Governing Council has yet to give its authorization to the transmission of the preliminary draft protocol to Governments. Specifically with a view to assisting with deliberations on the matter at the fortieth session of the Legal Subcommittee, in 2001, the meeting brought together both experts designated by those Governments which had already manifested a particular interest in the project during the thirty-ninth and forty-third sessions of the Legal Subcommittee and the Committee on the Peaceful Uses of Outer Space, respectively, and those experts representing the international commercial aerospace and financial communities involved in the work of the Space Working Group.

12. The results of the deliberations of the meeting of the restricted informal group of experts⁴ were considered at the subsequent meeting of the Space Working Group, also held in Rome, on 19 and 20 October 2000.⁵ The latest working draft of the protocol was prepared in January 2001 by Mr. Nsgos, assisted by Dara A. Panahy (Milbank, Tweed, Hadley & McCloy LLP, Washington, D.C.), in the light of the points made at the meetings of the restricted informal group of experts and the Space Working Group, as well as the amendments to the draft Unidroit convention and the draft aircraft protocol made at the meetings of governmental experts held to consider those texts subsequent to the preparation of the previous working draft of the protocol (to be issued in a conference room paper).

C. Principal features of the proposed new international regime governing the taking of security in space property

1. Draft Convention

13. The method chosen to overcome the legal and economic difficulties identified in paragraphs 3 and 4 above is the creation of a new international interest in mobile equipment. That interest has been defined in such a way as to embrace not only the classic security interest but also what are increasingly recognized as its functional equivalents, the seller's interest under a title retention agreement and the lessor's interest under a leasing agreement. The categories of mobile equipment in which such international interests may be held have been consciously limited to a relatively small number of high-value assets the common feature of which is that they all move regularly across or beyond national frontiers in the ordinary course of business. That restriction was designed to limit the scope for what might otherwise be considered unwarranted interferences with the application of domestic law rules.

14. At the heart of the draft Unidroit convention are the provisions for the creation of what is intended as an autonomous international interest, that is, an interest constituted by the future convention and not derived from or dependent on national law. That interest, if created in accordance with the very simple formalities required by the draft Unidroit convention, will be enforceable against the debtor whether or not it has been registered.

15. The draft Unidroit convention provides holders of international interests with a basic set of default remedies designed to be exercisable expeditiously, a matter adjudged to be of major practical significance for those contemplating lending against such high-value assets.

16. The international interest will be registrable in an international registry to be set up under the draft Unidroit convention. Separate registries are envisaged for each of the categories of equipment covered. Plans are already well advanced for the setting up of an aircraft registry and are under way for the setting up of a rail registry.

17. Registration will be the key to third parties knowing of the existence of international interests and to international interests enjoying priority over any

other interest subsequently registered as over any unregistered interest, international or otherwise. Registration will also be the key to the international interest's validity against the administrator and creditors in the debtor's insolvency.

18. The fact that the international registry is intended to be fully computerized means that it will be possible for a potential lender to make a search from any point in the world and to find out, more or less instantaneously, the precise status of the asset against which he is considering advancing funds. That fact alone explains why the draft Unidroit convention may be expected to make such a major difference to the future pattern of the asset-based financing of high-value mobile equipment.

2. Preliminary draft protocol

19. The future convention is intended to be applicable to space property only as from the time that the relevant State has become a contracting State to the future space property protocol and to the extent that its provisions are not amended by those of the protocol. The latter is intended to implement the future convention as regards all those matters which require special rules in the context of space property.

20. One of the principal functions of each of the protocols to the future Unidroit convention is the precise delimitation of the latter's substantive sphere of application in respect of each category of equipment covered by the same. This is done by means of definitions. The preliminary draft protocol thus provides a definition of space property, which is framed in broad terms so as to embrace, on the one hand, both tangible and intangible property and, on the other, property not necessarily known in the current state of space technology, such as products that might be manufactured in space. The future regime's application beyond mere tangible space property, such as satellites and transponders, was recognized at an early stage as being essential in view of the importance for a financier's ability to obtain constructive repossession of a satellite of his having access to the various rights associated with the operation of that satellite, in particular:

(a) Governmental licences and permits the assignment of which is permissible under national law;

(b) Intangible rights necessary to control, operate or transfer ownership of or rights in a satellite;

(c) Contractual rights relating to the operation of a satellite and the proceeds and revenues derived from the operation of a satellite.

Such associated rights are regarded as being inextricably linked to a satellite and integral to its commercial value.

21. Another important function of the future space property protocol is to provide the means of identification of the space property covered sufficient to serve as search criteria for use in conjunction with the future international registry for such property. While the manufacturer's serial number may be a sufficient search criterion for aircraft equipment—and has indeed been chosen for that purpose in the draft aircraft protocol—it has been recognized that not all items of space property by any means will dispose of such numbers or their equivalent, thus making it necessary to contemplate the possible use of multiple search criteria.

22. The difficulties implicit in exercise of the creditor's basic default remedy under the draft Unidroit convention, namely the taking of physical possession or control, in the context of most types of space property underline the importance of the provision in the preliminary draft protocol of a special additional remedy, namely constructive repossession (consisting of, for example, the exercising of control over space property from the ground via access and command codes).

23. The fact that a given satellite may form an integral part of an entire communications or operational system highlights the importance of the provision in the preliminary draft protocol whereby a creditor is debarred from taking possession or control in a manner that would contravene public order.

24. With a view to enhancing the opportunities for asset-based financing of space property, the preliminary draft protocol also introduces, through an optional insolvency regime, special rules designed to strengthen the creditor's position vis-à-vis the insolvency administrator in the event of the debtor's insolvency.

25. One area where the future space property protocol will need to implement the provisions of the draft Unidroit convention will be in determining the essential nature and framework of the international registration system for space property. The draft convention envisages the establishment or appointment

of a supervising authority, answerable to contracting States, which will enjoy international status and related privileges and immunities and be responsible for the establishment and administration of the international registry. This supervisory authority would also be responsible for the appointment of a registrar, who will carry out the day-to-day management of the registry and ensure its effective operation. It is currently envisaged that the registrar would be liable for compensatory damages for loss suffered by persons directly resulting from an error or omission in the registry and its officers and employees or from a malfunction of the international registration system and would be required to provide insurance or financial guarantees covering such liability. The registrar would also be necessarily subject to a degree of legal process under the national laws of at least one State. Of particular importance will be the identification of the bodies or persons appropriate to exercise the functions of supervisory authority and registrar.

D. Commercial advantages of the proposed new international regime for the financing of space property

26. The raising of the necessary finance for space activity has always caused special problems in view of the significant sums of money involved. Whereas up until 10 years ago most of the customers for such finance were either governmental or intergovernmental agencies or large multinationals or blue-chip companies with a long credit history and well able to raise financing without the need to grant security over their assets, the ever-growing trend towards the commercialization of space that is presently being witnessed has brought with it a change in the profile of the typical customer for space finance. Such customers will now increasingly be entrepreneurial companies with no real credit history and no significant assets to offer as collateral other than a satellite.

27. Such satellites will typically be commercial communication satellites, each of which will range in value from a few million to hundreds of millions of United States dollars and will have launching costs that may well be in excess of \$100 million. It is anticipated that more than 1,000 commercial communication satellites, valued at over \$5 billion and projected to generate well over \$500 billion in revenues, will be

launched over the next decade. This clearly represents a unique opportunity for asset-based financing.

28. Although certain international instruments, for instance the aforementioned Unidroit Convention on International Financial Leasing, contain provisions that may affect creditors' interests in space property, none of those instruments effectively deal with the international registration, recognition and enforcement of security rights in such property. Neither do the 1967 Treaty on Principles Governing the Activities of States in the Exploration and Use of Outer Space, including the Moon and other Celestial Bodies (the "Outer Space Treaty", General Assembly resolution 2222 (XXI), annex) nor the 1975 Convention on Registration of Objects Launched into Outer Space (the "Registration Convention", resolution 3235 (XXIX), annex).

29. Representatives of the space sector, whether satellite manufacturers, launch service providers, satellite operators or financial institutions, represented on the Space Working Group all agree as to the great benefits to be derived from a uniform, predictable and commercially oriented regime governing the taking of security in space property of the kind contemplated by the future convention and space protocol. Firstly, it will increase the willingness of financiers to lend funds for space commercial transactions. Secondly, the cost of such transactions, whether measured in terms of financial, legal or insurance costs, will as a result be much reduced in proportion to the consequential reduction in the financial risk at present incidental to such transactions.

30. The increased availability of asset-based financing for space-related ventures and the reduced cost of such financing that are likely to result from the proposed Unidroit regime may be expected to bring particular benefits for the new type of customers for satellite services, in particular in those developing countries and countries with economies in transition which until now might have experienced limited access to such financing possibilities.

III. Relationship of the proposed new international regime to the existing body of space law

31. Both Unidroit and the Space Working Group have concluded that there is nothing in the preliminary draft

protocol that is necessarily inconsistent with the existing body of space law, in particular the obligations subscribed to by States under the United Nations treaties on outer space. However, they agree as to the desirability of a paragraph being incorporated, say in the preamble to the preliminary draft protocol, ensuring that it in no way conflicts with or supersedes those obligations.

32. In recognition of the potential importance of the issues involved, moreover, the Space Working Group, at its last meeting, decided to set up an informal working group to consider the relationship between the preliminary draft protocol and those international instruments, whether already adopted or in preparation, which might be expected to have an impact on the provisions of the former.⁶

33. There was also extensive discussion of the question during the meeting of the restricted informal group of experts, at which discussions focused on the question from the angle of the interaction of the preliminary draft protocol both with national space law and with international space law.

A. Interaction with national space law

34. The discussions that took place on that occasion highlighted three areas in which the default remedy provisions of the preliminary draft protocol might prove to be a source of difficulty for certain States. Thus, in States where the vast majority of space property belonged to the State, it was to be expected that any attempt by a private party to take possession or control of such property would arouse vigorous opposition on the part of the authorities. Equally, in States that had passed mandatory legislation prohibiting the transfer of technology, in particular military technology, it was likely that the authorities would oppose transfers of such technology to unknown creditors. The third scenario indicated that, where a particular item of space property was required to guarantee a State's provision of a public service, in particular where safety or navigation systems were involved, such a State would probably object to a creditor seeking to take possession or control of such property without the provision of adequate guarantees of the continuing operation thereof under the same conditions and for the same purposes.

35. It was suggested that such difficulties could be resolved by one or other or a combination of two possible solutions. One option would be to permit such States to exclude the application of the protocol in respect of certain types of space property by means of an opt-out clause. The other would be to require such States to compensate the creditor for his losses in cases where the State's interests prevented the exercise of his remedies under the protocol, the idea here being to establish a fair balance between the interests of such States, on the one hand, and those of creditors, on the other.

B. Interaction with international space law

36. The only areas where the restricted informal group of experts was able to identify possible difficulties arising from interaction of the preliminary draft protocol with international space law concerned article II of the Convention on International Liability for Damage Caused by Space Objects (the "Liability Convention", General Assembly resolution 2777 (XXVI), annex) and articles VI and VIII of the Outer Space Treaty.

37. The restricted informal group of experts noted that a launching State could run the risk of finding itself liable under article II of the Liability Convention for a particular space object over which, by virtue of the transfer of that space object to a creditor subject to the jurisdiction and control of another State under the draft *Unidroit* convention as implemented by the preliminary draft protocol, it was no longer in a position to exercise control. It was noted that the transfer of space property to such creditor could also make it difficult for a State to honour its obligations under articles VI and VIII of the Outer Space Treaty. In that regard, it was noted that such issues were not limited only to creditors under the operation of the preliminary draft protocol, but also arose in connection with any transfer of ownership in space property to nationals of different States.

38. It was further noted that the definition of "space property" in the preliminary draft protocol, which determines the scope of application of the provisions thereof and the creditor remedies contained therein, could cause concern for contracting States seeking to

implement their responsibilities under article VI of the Outer Space Treaty.

39. With a view to being absolutely certain that the provisions of the preliminary draft protocol were wholly compatible with the international obligations subscribed to by States under the Constitution and Convention of the International Telecommunication Union (ITU), and in particular articles 33-48 of the Constitution, dealing, inter alia, with the questions of security of communications by satellite and the access to and use of radio frequencies and any associated orbits, the restricted informal group of experts decided that a questionnaire should be addressed to ITU.

IV. Issues before the Legal Subcommittee

40. Following the presentation made by Martin J. Stanford on behalf of Unidroit at the Workshop on Space Law in the Twenty-first Century, held as part of the Third United Nations Conference on the Exploration and Peaceful Uses of Outer Space (UNISPACE III)⁷ and in the light of the recommendations of UNISPACE III that attention be paid to the various aspects of the issues of liability and security of ownership in order to arrive at a coherent global framework and that the international organizations concerned make arrangements for effective and focused joint forums,⁸ both Unidroit and the Space Working Group concluded as to the desirability of the proposed new international regime for space property being brought to the attention of the Committee on the Peaceful Uses of Outer Space, given the responsibility of that Committee for the development of international space law in general and in particular in view of the responsibilities already exercised by the Office for Outer Space Affairs of the Secretariat in respect of the international registry of space objects provided for under articles III and IV of the Registration Convention.

41. Both Unidroit and the Space Working Group likewise believe in principle that the United Nations may be considered the most appropriate body to exercise the important functions of supervisory authority in respect of the future international registry for space property intended to underpin the future space property protocol, all the more so in view of the functions at present being exercised by the Office for

Outer Space Affairs under the Registration Convention. The conferring of those functions on an intergovernmental body has to date been seen as an important guarantee of the reputation of the particular international registration system with prospective users. It is worth noting in this context that, at the ninth meeting of its 161st session, held in Montreal, Canada, on 22 November 2000, the ICAO Council agreed that it would in principle be prepared to exercise the functions of supervisory authority in respect of the international registration system underpinning the draft aircraft protocol. The Intergovernmental Organization for International Carriage by Rail (OTIF) has indicated its interest in exercising similar functions in relation to railway rolling stock.

42. Consideration of the proposed new regime by the Committee on the Peaceful Uses of Outer Space and its Legal Subcommittee in 2001 is seen by them as being particularly timely in that the preliminary draft protocol is due to be submitted to the Unidroit Governing Council at its forthcoming eightieth session with a view to that body deciding on the next step to be taken in connection with this work and in particular whether it is to be considered ready for transmission to member Governments.

43. Two of the issues concerning the preliminary draft protocol likely to be of importance for the Governing Council's decision are, firstly, the question of its relationship to the existing body of space law and, secondly, that of the body that might be expected to exercise the functions of supervisory authority in the context of the future international registration system for space property. These are both issues which, in the opinion of Unidroit and the Space Working Group, might reasonably be expected to benefit from the particular expertise of the Committee on the Peaceful Uses of Outer Space and its Legal Subcommittee.

44. As has been indicated above, both Unidroit and the Space Working Group believe that there is nothing in the preliminary draft protocol that is necessarily inconsistent with the existing body of space law, even if a number of areas worthy of consideration were identified by the restricted informal group of experts. An informal working group of the Space Working Group has been set up to consider the relationship between the preliminary draft protocol and those international instruments which might be expected to

have an impact on its provisions. The opinion of both Unidroit and the Space Working Group is that there can however be no doubt that the relationship between the preliminary draft protocol and the existing body of space law is a question that the Committee on the Peaceful Uses of Outer Space and its Legal Subcommittee are particularly well fitted to explore.

45. In the light of the above discussion and taking into account the draft Unidroit convention and the preliminary draft space property protocol contained in the conference room papers, the Legal Subcommittee may wish to consider the following issues during the course of its deliberations on this item:

(a) The relationship of the proposed new international regime to the existing body of space law, including, inter alia, the issues mentioned in section III of the report;

(b) The nature and framework of the international registration system, its supervisory authority and registrar and in particular the identification of bodies or persons appropriate to exercise the functions of such supervisory authority and registrar;

(c) The role of the Committee on the Peaceful Uses of Outer Space and its Legal Subcommittee in the future development of the project and in particular the manner and scope of its future interaction with Unidroit in that regard;

(d) The form and manner by which the Legal Subcommittee would transmit its views, findings and/or recommendations with regard to the project to Unidroit and in particular its Governing Council;

(e) The future status of this item on the agenda of the Legal Subcommittee in the light of the deliberations and decisions of the Subcommittee at its fortieth session, in 2001.

Notes

¹ *Official Records of the General Assembly, Fifty-fifth Session, Supplement No. 20 (A/55/20)*, para. 166.

² International Institute for the Unification of Private Law, Ottawa, 1988.

³ See article 3 of the preliminary draft of the Unidroit convention on international interests in mobile equipment as established in 1997 by the study group at the conclusion of its fourth session and revised in 1998

by a steering and revisions committee (Study LXXII-Doc. 42).

⁴ See the report on the meeting prepared by the Unidroit secretariat (Study LXXIII-Doc. 1).

⁵ See the report on the meeting prepared by the Unidroit secretariat (Study LXXIII-Doc. 2).

⁶ *Ibid.*, sect. 15.

⁷ “Unidroit’s project for the creation of a new regimen governing the taking of security in high-value mobile assets: a window of opportunity in the context of the privatization and commercialization of space”, a commentary paper delivered during the session of the Workshop on the roles of international organizations in privatization and commercial use of outer space, reproduced in *Proceedings of the Workshop on Space Law in the Twenty-first Century* (ST/SPACE/2 (2000), pp. 148-151).

⁸ *Report of the Third United Nations Conference on the Exploration and Peaceful Uses of Outer Space* (United Nations publication, Sales No. E.00.I.3), para. 370.