

SECURED TRANSACTIONS

The Curious Case of Security Interests in FCC Licenses



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Whether a debtor's property is original collateral or proceeds of original collateral is an important distinction for purposes of lien perfection. However, the ramifications of this distinction go well beyond proper methods of perfection. The U.S. Bankruptcy Code¹ treats original collateral and proceeds quite differently, and even a properly perfected security interest cannot survive bankruptcy if it has attached merely to proceeds and not to original collateral.

An area in which this distinction is not only extremely relevant, but has taken on significant complexity, is liens on government licenses, specifically, liens on licenses issued by the Federal Communications Commission. Courts generally have found government licenses, such as FCC licenses, to constitute "general intangibles" under the Uniform Commercial Code (UCC).² At least in the case of FCC licenses, however, liens on such general intangibles are prohibited by the FCC.³ That prohibition is given effect under the UCC, which excludes from the scope of Article 9 any security interest preempted by a U.S. statute, regulation or treaty.⁴ Consequently, an FCC license itself may not be subject to a lien under Article 9 of the UCC.

The "economic value" associated with such licenses, such as "proceeds" of the sales of such licenses, is an entirely different matter. The FCC expressly blesses such liens.⁵ Nevertheless, in a bankruptcy proceeding, a creditor asserting a lien on proceeds of a license in a bankruptcy proceeding, while lacking a lien on the license itself, needs to overcome the general Bankruptcy Code prohibition on pre-petition liens attaching to collateral after a bankruptcy filing. The struggles of secured lenders to convince bankruptcy courts that proceeds of the sale of an FCC license are original collateral, and, in particular, that a lien on such collateral has attached pre-petition, are highlighted in two recent federal court decisions discussed below. These concepts, and the related underlying question of whether a debtor who has no right to transfer an asset could nevertheless have sufficient other rights in that asset for a security interest therein to attach pre-petition, have broader application for other types of collateral as well.

FCA, UCC and the Code

The Federal Communications Act of 1934⁶ (FCA) provides for the use of channels of communication,

but not the ownership thereof, by persons "for limited periods of time, under licenses granted by Federal authority" and prohibits the transfer, assignment or other disposition in any manner of an FCC license or any rights thereunder without consent of the FCC.⁷ Based on the FCA, the FCC has stated that a security interest in an FCC license violates FCC policy.⁸ In 1994, however, the FCC issued a clarifying order in which it declared that a security interest in the proceeds of the sale of a license does not violate its requirements.⁹ In fact, the FCC has emphasized that permitting such security interests will improve licensees' access to capital.¹⁰

Based on the Federal Communications Act of 1934, the FCC has stated that a security interest in an FCC license violates FCC policy.

Since, as noted above, the UCC defers to federal law when, and to the extent that, federal law preempts it, courts have also generally agreed that a lien cannot be placed on the entirety of the FCC license itself.¹¹ Accordingly, the focus of both debtors and lenders has been on how to give effect to both the FCC policy prohibiting liens on the licensed government rights and the FCC order allowing (indeed encouraging) the economic benefits of the licenses to be available as collateral for financings by secured creditors.

The Bankruptcy Code presents a challenge in reconciling these policies. Pursuant to Bankruptcy Code §552(a), a secured party's pre-petition lien generally does not attach to property acquired by a debtor after the filing of its bankruptcy petition. Instead, such lien generally is limited to collateral already existing on the petition date. An exception to this general rule is §552(b), which provides that the secured party's pre-petition lien will attach to collateral that constitutes proceeds of its pre-petition original collateral.¹²

A security interest must "attach" to personal property under the UCC in order to become enforceable against the debtor (although if then not perfected, such security interest may not be enforceable against certain third parties, such as a trustee in bankruptcy). Generally, a security interest attaches to collateral under the UCC when (1) the debtor authenticates a security agreement that adequately describes the collateral, (2) the secured party gives

value to the debtor, and (3) the debtor has rights or the power to transfer rights in such collateral.¹³

Creditors in a bankruptcy proceeding asserting a pre-petition lien on the sales proceeds of an FCC license must therefore overcome two arguments. First, the creditor cannot claim a lien on proceeds of an FCC license, since the license itself was not and cannot be subject to a security interest. Second, a security interest cannot under the UCC attach to proceeds of the post-petition sale of the license as pre-petition original collateral since such proceeds did not exist prior to commencement of the bankruptcy proceeding.

Recent Decisions

The courts in two recent cases, *In re Tracy Broadcasting*¹⁴ and *In re TerreStar Networks*,¹⁵ wrestled with these issues. The bankruptcy court in *TerreStar* upheld the lien on the proceeds of sale of the license. Conversely, the bankruptcy court in *Tracy* ruled and, on appeal, the federal district court affirmed, that such security interest did not survive the filing of the bankruptcy case. However, in an opinion issued on Oct. 16, 2012, the Tenth Circuit overruled the two lower courts and held that the bank lender in that case had a perfected security interest in the proceeds of the post-petition sale of the license. In so doing, the Tenth Circuit joined not only the *TerreStar* court, but a number of other federal courts.¹⁶ Accordingly, in a somewhat back-and-forth set of opinions, *TerreStar* and *Tracy* ultimately reached the same conclusion.

'In re Tracy Broadcasting': Bankruptcy and District Courts. *Tracy Broadcasting* was a Nebraska corporation that held an FCC license to operate an FM radio station in Wyoming. In 2008, Valley Bank & Trust provided a loan to *Tracy* secured by a lien on, among other assets, *Tracy's* general intangibles and the proceeds thereof. *Tracy* filed for bankruptcy in August 2009, and Valley Bank claimed a security interest in any proceeds from the future sale of the debtor's FCC license. That claim was promptly challenged by *Tracy's* other large creditor: Spectrum Scan, which brought an adversary proceeding to determine the extent of the bank's security interest. The parties agreed that the bank had no security interest in the license itself, so the sole question of law was whether *Tracy* had a sufficient property interest in the license pre-petition to avoid the effects of Bankruptcy Code §552(a).

The bankruptcy court held that the only interest *Tracy* could convey was a right to receive proceeds upon an FCC-approved transfer of its license. This right, however, was ruled to be too remote to exist

prior to the filing of the debtor's Chapter 11 case, as it was subject to two contingencies: an agreement to transfer the license and FCC approval of the transfer. The bankruptcy court thus ruled on Oct. 19, 2010 that Valley Bank had no priority in the proceeds of any sale of the FCC license. The District Court for the District of Colorado affirmed on Aug. 31, 2011.

'In re TerreStar Networks'. TerreStar Networks was a mobile satellite services provider licensed by the FCC. TerreStar had issued \$500 million of notes in 2008 which, as in *Tracy*, were secured by all general intangibles, including:

all FCC Licenses, including, without limitation, the right to receive monies, proceeds or other consideration in connection with the sale, assignment, transfer, or other disposition of any FCC License, the proceeds from the sale of any FCC License or any goodwill or other intangible rights or benefits associated therewith....

The security agreement expressly excluded any FCC license to the extent a lien on such license was not permitted pursuant to federal law, rules and regulations.

TerreStar and its affiliates filed for Chapter 11 in the Southern District of New York on Oct. 19, 2010 (coincidentally, the exact same day on which the *Tracy* Bankruptcy Court issued its opinion). In December 2010, Sprint Nextel commenced an adversary proceeding against the notes' trustee seeking to have the noteholder liens declared invalid. In July 2011, TerreStar sold substantially all of its assets, including the FCC license, subject to approval of the FCC.

The *TerreStar* opinion, covering substantially the same issues as *Tracy*, was issued on Aug. 19, 2011, only days before the district court affirmed the *Tracy* bankruptcy court ruling. Indeed, Sprint relied on the *Tracy* opinions to support its contention that the debtor did not have rights in the FCC license itself, and thus could not create an enforceable pre-petition security interest in the proceeds from the post-petition sale of the license. Sprint argued that because no sale or transfer of the underlying assets had occurred before the bankruptcy, the lien had not attached under UCC Article 9 and for purposes of the Bankruptcy Code. Therefore, §552 barred the secured creditor from asserting its security interest in the proceeds of the sale of the FCC license post-petition.

In its opinion, the *TerreStar* court ruled it was "settled law" that while a lien cannot exist on the entirety of an FCC license itself, a security interest may attach to the "economic value" of the license, and that the noteholders can have a valid lien on such economic value.

The court then proceeded to discuss the sanctity of this lien under §552. Citing the FCC itself and case law precedent, the court relied heavily on the distinction between what it described as the public and private rights relating to an FCC license, characterizing the public right as the right to regulate the license itself and the private rights as all attributes of the license not explicitly reserved to the FCC. It criticized Sprint's arguments and the *Tracy* ruling, holding that *Tracy* ignored that distinction by placing two problematic conditions on the attachment of a lien against the economic value of a license: a sale and FCC approval. Such conditions, according to the court, would make it difficult, if not impossible, for such lien to survive bankruptcy, thereby thwarting the FCC's objective to encourage financings secured by the economic benefits of FCC licenses.

'In re Tracy Broadcasting': Tenth Circuit Court of Appeals. On Oct. 16, 2012, the Tenth Circuit Court

of Appeals reversed the lower court decisions in *Tracy*.

The circuit court first held that, consistent with the FCA and FCC policy, an FCC licensee had a sufficient private property interest in the right to proceeds of a sale of its license, and in the proceeds of such right (that is, the actual proceeds of a sale), to grant a lien on that right. In the court's view, this right was a "general intangible" and, accordingly, subject to perfection prior to sale. The court contrasted the right of an FCC licensee to use the electromagnetic-wave spectrum with its right to make money on such license, noting that the FCC does not prohibit private rights in value created by a licensee's use of the airwaves. It tossed aside Spectrum Scan's argument that, by allowing a private right to be subject to a security interest, the FCC had misinterpreted the FCA.

The court then examined whether, for purposes of §552 of the Bankruptcy Code, the debtor's right to proceeds under Nebraska law was in fact too remote for a security interest to attach pre-petition.¹⁷ In this analysis, the court relied heavily on the anti-assignment provisions of UCC §9-408.¹⁸

The view of the Tenth Circuit, and the intellectually sounder view, is that the property right attaches to the economic value of the FCC license, meaning the right to receive proceeds.

In the court's view, UCC §9-408(c) would override state licensing laws requiring government permission to perfect a security interest in state-issued licenses virtually identical to the security interest claimed by Valley Bank. In so doing, the court states, the statute implicitly recognizes the propriety of perfection of a security interest in federal licenses when, as in this case, no federal law would be violated thereby.¹⁹ Accordingly, the court was "confident" that, even without a pending sale of a license and governmental approval, Nebraska law would not view the right to proceeds of the license sale as too speculative to support the attachment of a lien on that right.

Conclusion

The fundamental task before each of these courts was divining the line between original collateral and proceeds of collateral, but the basic question was when is property of a debtor sufficient in substance to support attachment of a security interest. In the context of FCC licenses, this became an analysis of determining what rights can be made subject to a lien without offending government prohibitions, and whether contingencies regarding those rights render them too uncertain to support creation of a security interest.

The view of the Tenth Circuit, and the intellectually sounder view, is that the property right attaches to the economic value of the FCC license, meaning the right to receive proceeds. Notably, the court stated that if the security interest was solely in the license sales proceeds, it could not attach before those proceeds existed (i.e., before the sale was consummated). However, the distinction between proceeds themselves as original collateral and as proceeds of original collateral is fine and one which the opinion itself does not consistently observe. Contributing to this confusion is the terminology of

the FCC policy permitting a security interest solely "in the proceeds of the sale" of a license. Although the Tenth Circuit rationalizes this language as merely emphasizing that the secured party cannot realize monies on its security interest until a sale occurs, the FCC has not formally approved this interpretation.

The opinions of the Tenth Circuit in *Tracy* as well as the bankruptcy court in *TerreStar* are clearly results-oriented in their efforts to accommodate the stated purpose of FCC policy. The Tenth Circuit readily admitted that "commercial realities" mandated reversing the decisions below. Both courts noted that if a security interest could not attach before there was a contract for sale of the license, the lien would have little value, particularly when the sale is made by a licensee in financial distress.

Uncertainty regarding FCC approval of the *Tracy* and *TerreStar* analyses should not dissuade creditors from taking a lien on private rights relating to FCC licenses, but creditors should be cautious in relying heavily on such liens as part of their collateral package. Although the Tenth Circuit has now generally aligned itself with other jurisdictions, "economic value" as a property interest remains a somewhat murky concept. It is also important to note that subsection (c) of UCC §9-408, on which the *Tracy* circuit court places significant emphasis, was not adopted in New York.

The rationale expressed in *Tracy* and *TerreStar* could also apply to other assets subject to government assignment restrictions, including such varied collateral as worker compensation benefits, cable television franchises and state-issued hazardous waste operating permits. Practitioners with clients seeking to obtain liens on these types of assets should therefore closely review these court decisions.

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- 11 U.S.C. §§101, et seq.
 - See *In re TerreStar Networks*, 475 B.R. 254 (Bankr. S.D.N.Y. 2011).
 - In re Walter O'Cheskey*, 9 FCC Rcd. 986 (Mobile Serv. Div. 1994), aff'd, *In re Walter O'Cheskey*, 13 FCC Rcd. 10656 (1998).
 - UCC §9-109(c)(1), and cmt 8 to such section.
 - Walter O'Cheskey*, 13 FCC at 10660.
 - 47 U.S.C. §§151, et seq.
 - See 47 U.S.C. §310 generally and §310(d) in particular.
 - In re Kirk Merkle*, 94 FCC2d 829 (1983).
 - Walter O'Cheskey*, 9 FCC Rcd at 987.
 - Facilitating the Provision of Spectrum-Based Services, 69 Fed. Reg. 75, 144, 151 (Dec. 15, 2004).
 - See, e.g., *In re Ridgely Communications*, 139 B.R. 374 at 378-79 (Bankr. D. Md. 1992).
 - 11 U.S.C. §522.
 - UCC §9-203(b).
 - 438 B.R. 323 (Bankr. D. Colo. 2010), aff'd, 2011 WL 3861612 (D. Colo. Aug. 31, 2011), rev'd, 696 F.3d 1051 (10th Cir. 2012).
 - 475 B.R. 254 (Bankr. S.D.N.Y. 2011).
 - MLQ Investors v. Pacific Quadracasting*, 146 F.3d 746 (9th Cir. 1998) cert. denied, 525 U.S. 1121 (1999); *Urban Communicators PCS v. Gabriel Capital*, 394 B.R. 325 (S.D.N.Y. 2008); *In re Media Properties*, 311 B.R. 244 (Bankr. W.D. Wis. 2004).
 - The court noted the agreement of the parties that Nebraska's version of the UCC controlled. See 696 F.3d at 1054.
 - UCC §9-408 overrides, in certain specified circumstances, prohibitions on the assignment, transfer or creation of a security interest on, among other assets, general intangibles, although such override does not itself entitle the secured creditor to enforce its security interest.
 - Note that UCC §9-408 does not override federal law. See cmt. 9 to UCC §9-408.