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A Tale of Two Bankruptcies: Colorado Court Rejects and New York Court Upholds Validity of Security Interests Associated with FCC Licenses

BY JESSE H. AUSTIN, III, MATTHEW L. GIBSON, ERIC DODSON GREENBERG & JENNIFER ST. JOHN YOUNT

Over the past year, a bankruptcy proceeding in Colorado – *In re Tracy Broadcasting* – has called into question creditors' ability to take a security interest in the proceeds from the future sale in bankruptcy of spectrum licenses issued to borrowers by the Federal Communications Commission. But, in a contemporaneous proceeding aligned with the majority view – *In re TerreStar* – the influential Bankruptcy Court for the Southern District of New York upheld the right of the *TerreStar* creditors' security interest in the proceeds from the sale of the company's FCC licenses and sharply criticized the *Tracy* decision. In light of these seemingly contradictory decisions, FCC-regulated borrowers and their creditors may wonder whether the decision in *Tracy*, although an outlier to the prevailing view, changes the landscape of courts' treatment of security interests in proceeds from the sale of FCC licenses – a shift that could impede the value of collateral packages within the communications and broadcasting sectors.

Discussion of these two decisions has tended to focus on the bankruptcy courts' dueling legal analyses and on the absence of a definitive FCC decision cementing the agency's policy on this issue. Framed this way, commentators have raised the specter of uncertainty about how courts would address FCC-regulated licenses in connection with collateral packages. Unpredictable judicial treatment fosters uncertainty in the market, which, in turn, could impinge upon the collateral value associated with such regulated assets. We believe that Article 9 of the UCC, in fact, offers clarity here, and provides a result different from that reached by the *Tracy* court. But while the two cases may be best understood analytically from the perspective of what broad grants of security the UCC permits, the lesson to practitioners may lie in the limitations imposed by FCC regulations.

In a decision that survived district court review, the *Tracy* bankruptcy court determined that the creditor did not hold a valid pre-petition security interest in the proceeds from the sale of the FCC license because the creditor's interest in the proceeds was "subject to two contingencies": (*i*) an agreement to sell the FCC license, and (*ii*) the FCC's approval of such a sale. According to the *Tracy* court, because neither contingency was satisfied pre-petition, the creditor could not claim that the proceeds from a post-petition sale of the FCC license were a "general intangible" in which it held a valid, pre-petition security interest.

The *Tracy* court poses the question as follows: Did the debtor have sufficient "rights in the collateral or the power to transfer rights in the collateral to a secured party" such as would be necessary for a security interest to attach under Section 9-203 of the UCC prior to the bankruptcy filing? The *Tracy* court answers with a resounding “no.”

This is the place in the *Tracy* court’s analysis where the UCC would appear to offer a different result. The *Tracy* court suggests that a debtor cannot grant a security interest in a right for which the value has not yet been realized, but the UCC permits a debtor to grant a security interest in whatever rights the debtor has in a particular asset – even if those rights are limited and even if the full value of those rights has not yet been realized. For example, a creditor may take a security interest in the economic value of a debtor’s rights in a joint venture, even if the creditor does not have a security interest in the joint venture itself.

If the *Tracy* decision seems to create a near-impossible hurdle for creditors – pre-petition FCC approval of a license sale – the Bankruptcy Court for the Southern District of New York’s decision in *TerreStar*, together with the case’s underlying facts, provides a ready and effective antidote. As in *Tracy*, the court in *TerreStar* was asked to analyze a creditor’s claim arising from a pre-petition security interest in the underlying economic value of FCC licenses. And, as in *Tracy*, the parties in *TerreStar* entered into a security agreement that granted a security interest in general intangibles to the creditor. Yet the court in *TerreStar* concludes that the creditor had “a valid lien on the economic value associated with” the debtor’s FCC license, even if the creditors cannot hold a lien on the FCC license itself.

Unlike the security agreement in *Tracy*, the security agreement in *TerreStar* included specific language focused on “the right to receive monies, proceeds, or other consideration in connection with the sale, assignment, transfer, or other disposition of any FCC licenses, the proceeds from the sale of any FCC licenses or any goodwill *or other intangible rights* or benefits associated therewith . . . .” For Article 9 purposes, this fact should not distinguish *TerreStar* from *Tracy*, however. Such “rights to money, proceeds, or other consideration” is simply a general intangible under Article 9. Article 9 was premised on the notion that secured parties should be able to confidently rely on describing collateral in their security agreements by using the broad categories outlined in Article 9. While descriptions that are more specific than the broad categories should not prejudice a secured creditor, such descriptions should not be required. As the court in *TerreStar* points out: “There is no reason why the proceeds should not be considered general intangibles.”

Tracy and *TerreStar* could be understood strictly on UCC grounds, but in this tale of two bankruptcies, that is only half of the story. Holders of spectrum licenses must adhere to FCC regulations that prohibit the grant of security interests in spectrum licenses. Thus, despite *TerreStar’s* favorable UCC analysis, parties attempting to secure interests in the economic value of FCC licenses do not have the luxury of relying only on broad grants in “general intangibles” because such a broad grant would include as collateral the very thing that the FCC requires be excluded: the FCC licenses. Instead, holders of spectrum licenses and their creditors must fashion precise security agreements that are both consistent with FCC regulatory requirements and Article 9.

The vectors of FCC and UCC requirements have, in important part, propelled the communications industry to develop practices that have implications in the drafting of security agreements and in the structuring of the entities that hold FCC licenses. While Article 9 permits some elasticity in defining the scope of collateral, FCC requirements call for specificity in excluding spectrum licenses from such collateral. Indeed, in certain circumstances, particularly when seeking FCC consent to the acquisition of a television or radio station, FCC-regulated borrowers must affirmatively certify compliance with the FCC’s policies pertaining to grants of future interests, and such certifications specifically include a confirmation that the applicant has not granted and will not grant a security interest in a spectrum license. Arguably, a security agreement relying solely on Article 9's broad categories could bar such a certification. And, once the spectrum licenses are themselves excluded from collateral, parties may wish to make explicit that the collateral includes the economic value associated with the licenses to avoid a possible misperception of a tension – between what the UCC permits and what the FCC limits – that would impede a creditor's ability to realize the economic value associated with the FCC licenses. Accordingly, practitioners would continue to be well-advised to make explicit that the exclusion of an FCC license from a collateral package does not limit the creditor's continuing security interest in either the revenues derived from its use or in any proceeds from its disposition. As a symmetrical concept, practitioners may also include additional savings language that operates to automatically establish a security interest in the FCC license in the event that, whether upon a change of law or policy, the grant of such a security interest is permissible.

Moving beyond the description of the economic value of an FCC license, it is also not unusual within the communications and broadcast sectors for businesses to form special purpose vehicles for the sole purpose of holding FCC authorizations. This type of structure allows a borrower to include in its collateral package a pledge of the equity of the license subsidiary. Although the FCC would still have to consent to the sale of the license or the transfer of control of the license subsidiary, such a pre-petition arrangement provides creditors with yet another layer of security and certainty. Indeed, it is noteworthy – if also perhaps unsurprising – that TerreStar held its FCC licenses in special purpose vehicles, while Tracy Broadcasting did not.

In the end, the contradictory rulings of these two bankruptcy cases offer a singular lesson for the unwary on the potentially complex interplay of communications law and the UCC. While we believe that the UCC supports the security interests granted in each case, it is clear that hewing to best practices for secured finance in the communications and broadcast sectors offers both borrowers and creditors the greatest certainty in the twin arenas of FCC compliance and collateral enforcement.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

Atlanta

Jesse H. Austin, III
1.404.815.2208
jessaustin@paulhastings.com

Washington, DC

Eric Dodson Greenberg
1.202.551.1343
ericgreenberg@paulhastings.com

Matthew L. Gibson
1.202.551.1793
matthewgibson@paulhastings.com

Los Angeles

Jennifer St. John Yount
1.213.683.6008
jenniferyount@paulhastings.com