Securing a Loan to a Broadcaster, Part 2 - Bankruptcy Cases and Liens on Licenses

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When an FCC licensee goes bankrupt, the question of how to treat the interests of secured lenders is the one that, from time to time, comes up for debate. Two recent cases deal with this issue – one appearing to be an aberration that would make lending to a broadcast licensee difficult if not impossible, while the second providing a more lender-friendly interpretation after a detailed analysis of the history of FCC and court precedent on this issue, affirming what most in the broadcast community have assumed, for most of the last two decades, is settled law. We wrote last week about how the **FCC's prohibition on taking a security interest in an FCC license** can make enforcement of liens difficult in a normal debtor-creditor context. Today, we'll look at how the FCC's prohibition on taking liens in a license has significance in the bankruptcy context.

Due to the FCC's prohibition on taking a security interest in an FCC license, if the FCC reviews any **security agreement with a licensee company**, it will insist that **lenders need to make clear in such agreement that the lender has no security interest directly in the FCC license**. In most agreements, lenders now have that language, with a caveat that such an interest is renounced only for so long as FCC policy remains in its current state – though, as set forth below, that policy does not look like it will change anytime soon. As the FCC license is usually the most valuable asset of a licensee, to preserve its ability to get at the value of that license in the event of a default on the loan, even though it cannot take a lien in the license itself, the lender will include a provision in its security agreement that gives it a **secured position in the proceeds from any sale of that license** and in all other intangible assets of the licensee. Having a secured interest is important to lenders as it gives the lender priority over unsecured creditors in the event of a bankruptcy. Thus, if the lender goes into bankruptcy and there are insufficient funds to pay all creditors (as is usually the case), the secured party will get first crack at the assets that are available to pay debts. The question of whether such priority should attach to the proceeds from the sale of an FCC license, when that sale may not occur until after the bankruptcy has been declared, was the heart of the controversy in the recent cases.

Before looking at the recent cases, it is important to look at the history of the debate over broadcast security interests, as one of the recent cases seems to ignore the fact that these issues have already been debated and seemingly resolved. In the early 1990s, there were two conflicting court cases looking at whether a creditor had a secured position in the proceeds from the sale of a broadcast license. One case, in the bankruptcy of ***Tak Communications***, found that the lack of a lien directly on the broadcast station license meant that the creditor had no secured interest in any aspect of the license, including the proceeds from its sale. The other case ***(Ridgely Communications***) reached a contrary conclusion – holding that the FCC's reason for prohibiting a security interest in a license was simply to preclude a sale of a license without the approval of the Commission. This policy interest was not implicated by allowing a creditor to have a secured interest in the proceeds of the license, as long as the sale itself was approved by the FCC. The FCC itself weighed in on these conflicting decisions in a case called ***In re Chesky***, favoring the position of of the ***Ridgely*** court. Numerous courts in the years since have agreed with that position – allowing secured creditors to enforce their liens on the proceeds of a sale of an FCC license (both broadcast and non-broadcast licenses) in bankruptcy, and the FCC's own practice and its discussions of related issues in subsequent cases seem to confirm this position. Thus, all seemed settled until last year.

In October, 2010, a case from a Colorado bankruptcy court created some consternation in the lending community. This case, relating to the bankruptcy of ***Tracy Broadcasting Corporation***, held that, while a lender could have a security interest in a license, that interest could be enforced only when there were proceeds that already existed before the declaration of bankruptcy. In other words, the broadcast station involved would have had to have been sold before there was any bankruptcy filing for the security agreement in the proceeds to be effective, which will almost never be the case. The Court concluded that the proceeds from a sale of a station after a bankruptcy petition was filed was not subject to the lien of the secured creditor, as the proceeds were acquired after the bankruptcy petition. In most cases, a creditor can not acquire any preferred position in after-acquired property without the prior consent of the bankruptcy court (e.g. for post-petition lenders to a company in a reorganization). The ***Tracy*** case is currently on appeal.

Naturally, this case created some concern with lenders to broadcast companies and other FCC licensees. The ***Tracy*** decision and its reasoning was raised by unsecured creditors in another recent case, in an attempt to void the lien of secured creditors on the proceeds from the sale of a non-broadcast FCC license. In this case, involving the bankruptcy of ***Terrestar Networks Inc***, a New York bankruptcy court decision (decision by Judge Gonzalez on August 19), rejected the ***Tracy*** reasoning. The ***Terrestar*** court did an extensive review of case law on security in FCC licenses and the proceeds from the sale of those licenses, and revealed many flaws in the Colorado decision. The New York court noted that the only case cited by the Colorado court in support of its position was the ***Tak*** case, the reasoning of which was explicitly rejected by the FCC in its later ***Chesky*** decision. The NY Court surveyed the dozens of subsequent cases decided in the last 20 years, all of which had approved the position that a secured creditor could take a security interest in the proceeds of the sale of a license – even when that license was sold after the bankruptcy petition. As the court stated, to rule otherwise would make the FCC's approval of security interests in the proceeds of the sale of a license to be meaningless, as it will almost always be the case that a license will be sold after the declaration of bankruptcy. The Court also noted that a security interest in any intangible (and intangibles are specifically covered by article 9 of the UCC as an asset in which a secured interest can be held) will rarely ever have value until the intangibles are sold. To hold in the manner that the ***Tracy*** court did, that there the secured interest did not attach to the proceeds from the sale of a license, would be to undercut the ability of a creditor to meaningfully benefit from its security interests in intangibles.

While the NY Court's extensive analysis of the history of security interests in station licenses appears persuasive, no doubt creditors will always fight over this issue as long as the FCC's peculiar position persists preventing a security interest in an FCC license. This will continue to cause confusion to local courts unfamiliar with the historical record reviewed by the NY Court.

In the mid-1990s, after the last flap about this issue, certain lenders petitioned the FCC to look at whether a security interest should be allowed in an FCC license. No final decision on this petition was ever reached. As these issues continue to come up from time to time, it would seem that the FCC could modify its position to some degree – recognizing that a security interest could be taken in a broadcast license, but that such interest could not be foreclosed on without prior FCC approval. The FCC has recognized other intangible interests in licenses – licensees can sell licenses, or grant options to acquire the licenses, and the FCC will have no issue with enforcing court decisions concerning such interests as long as any actual license transfer resulting from the interest is not finalized until the FCC has given its approval to the ultimate buyer. Why wouldn't that same process work for security interests in FCC licenses? A thought for the FCC to consider – perhaps when they next decide to revisit this archaic and confusing policy.