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NEW DECISION CONFIRMS THAT SECURED CREDITORS MAY HAVE LIEN ON ECONOMIC VALUE OF FCC LICENSE

By: Sharon L. Levine, Esq., Wojciech F. Jung, Esq., and Thomas Livolsi, Esq.

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In a recent decision¹ involving **TerreStar Networks, Inc.**, and its affiliates (“TerreStar” or the “Debtors”), the United States Bankruptcy Court for the Southern District of New York held that the Debtors’ noteholders held a valid lien on the economic value of a license granted to TerreStar by the Federal Communications Commission (“FCC”) and that nothing in Article 9 of the New York Uniform Commercial Code (the “NYUCC”) or Section 552 of the Bankruptcy Code invalidated that lien. The question of whether a secured lender can obtain a valid lien on an FCC license has been subject to contested debates and contradictory decisions of late, with some courts holding that FCC licenses cannot be encumbered, while other courts, in differentiating between the economic and non-economic attributes of an FCC license, have held that lenders may encumber such economic attributes of the license without violating public policy. The *TerreStar* court, relying heavily on a decision issued by Judge Peck in 2009 in the case of *Ion Media Networks*, sided with the lenders who claimed

to have perfected their liens in TerreStar’s economic interest in the FCC license when they extended TerreStar approximately \$500 million in loans in 2008.

The facts of *TerreStar* are straightforward. TerreStar is a mobile satellite services provider whose business requires an FCC license. Before TerreStar filed for bankruptcy, Sprint Nextel Corp. (“Sprint”) had filed claims in federal district court against TerreStar in the amount of \$104 million for TerreStar’s share of Sprint’s costs to clear the bandwidth that TerreStar now uses. Sprint asked the Bankruptcy Court to invalidate the lien of secured noteholders on TerreStar’s license assets. In the alternative, Sprint requested that the Bankruptcy Court subordinate the noteholders’ claim to Sprint’s claim. Sprint’s request for the invalidation or subordination of the noteholders’ alleged liens on TerreStar’s FCC license was intended to free up value for its own unsecured claim.

Sprint’s complaint asserted four counts.

- According to Count I, the noteholders’ lien could not attach to the FCC license itself and therefore was invalid.

- Count II contended that, even if the noteholders could have a lien on the economic value of the license, the lien was not effective because it could not attach under Article 9 of the NYUCC until proceeds from the license were realized through either a sale or other transfer of the license and because Section 552 of the Bankruptcy Code prohibits postpetition retention of liens on prepetition property (to, for example, receive proceeds from the sale of the property) where such liens were not perfected prepetition.
- Under Count III, Sprint argued that, assuming a valid lien on the license, the equities of the case provision in Section 552(b)(1) of the Bankruptcy Code justified invalidating or subordinating the noteholders’ lien to Sprint’s claim for reimbursement.
- Finally, Count IV stated that the lien should be subordinated to Sprint’s claim pursuant to Section 506(a)(1) of the Bankruptcy Code and Article 9 of the NYUCC because

the FCC conditioned TerreStar's license upon reimbursement to Sprint for clearing the bandwidth that TerreStar now uses.

Sprint moved for summary judgment on Counts I, II, and IV, with the support of the Official Committee of Unsecured Creditors on Counts I and II. U.S. Bank, the indenture trustee, cross-moved for summary judgment on all counts, arguing that a lien could exist on the economic value of an FCC license, even though a security interest could not be granted in an FCC license itself. An *ad hoc* committee of noteholders supported U.S. Bank's cross-motion as to Counts I and II. U.S. Bank and the noteholders also argued that neither Article 9 of the NYUCC nor Section 552 of the Bankruptcy Code barred a lien on the economic value of the license. The Bankruptcy Court agreed with the arguments of U.S. Bank and the noteholders and granted summary judgment in their favor on Counts I, II, and IV. As for Count III, the Bankruptcy Court held discovery had to be completed before that claim would be ripe for adjudication.

The loan documents underlying TerreStar's obligation to the noteholders made clear that the noteholders' security interest did not extend to the FCC license itself. The offering memorandum for the notes also acknowledged that the lien did not cover the license itself.

An FCC policy required licensees, such as the Debtors, to reimburse Sprint for band-clearing costs. As those costs remained unpaid at the time of the bankruptcy filing, Sprint filed unsecured claims with the Bankruptcy Court against each of the Debtors.

The Bankruptcy Court examined two cases in which federal courts reached

opposite conclusions on whether a lender could assert a lien on an FCC license. The court in *In re Ridgely Communications, Inc.*, 139 B.R. 374 (Bankr. D. Md. 1992), answered the question in the affirmative by holding that a lender had the right to the proceeds realized from the debtor's sale of the FCC licenses because the debtor had the right to grant liens on its private rights associated with its FCC license and that granting such a lien did not contravene the FCC's desired controls over assignments, transfers and regulation of FCC licenses. As the granting of a lien on the debtor's economic interest in an FCC license does not disrupt the regulatory control of the FCC, the court upheld the grant of the lien on the license to the extent of "the licensee's proprietary rights in the license vis-à-vis private third parties." *Id.* at 379.

The court in *In re Tak Communications, Inc.*, 138 B.R. 568 (W.D. Wis. 1992), *aff'd*, 985 F.2d 916, 916-17 (7th Cir. 1993), took a more narrow view on the encumbrance of an FCC license. In *Tak*, the court limited a lender's lien on all of the debtor's tangible and intangible assets by excluding an FCC license from the lien. Recognizing that whether to permit a lien on an FCC license is a matter for the FCC to decide, the *Tak* court cited prior FCC rulings prohibiting creditors from holding a lien on FCC licenses. 985 F.2d at 918-19. Those rulings, according to the Seventh Circuit, were clear indications that the FCC made no distinctions between private and public rights or attributes of an FCC license.

The court in *TerreStar* rejected *Tak's* holding by stating that subsequent FCC rulings and court decisions permit a creditor to perfect a lien in the private economic value of an FCC

license to the extent that the lien did not violate the FCC's public policy to regulate license transfers. The *In re Cheskey* ruling of the FCC and the *Ion Media* court decision were the principal sources of authority relied upon by the *TerreStar* court in validating the noteholders' liens on TerreStar's economic interest in its FCC license. In permitting the noteholders' to claim secured status, the *TerreStar* court held that, under the applicable provisions of the security agreement, the noteholders had a valid lien on the economic value of the FCC license granted to TerreStar, even though they had no lien on the FCC license itself.

Further, the *TerreStar* court rejected Sprint's argument that the lien on the economic value of the FCC license was invalid under Article 9 of the NYUCC and Section 552 of the Bankruptcy Code. According to Sprint, the lien could not attach to any proceeds of a FCC license until a sale or other transfer of the license took place and would necessarily be a prohibited postpetition lien under Section 552 of the Bankruptcy Code. The *TerreStar* court rejected Sprint's argument by noting that the decision on which Sprint relied² to support its argument was "problematic," as the court in that case made "the faulty assumption" that the FCC had not ruled on the issue of liens on FCC licenses. Moreover, other than that lone decision, "courts have uniformly recognized that an FCC license is a general intangible and that a lien on such an intangible may be perfected prepetition before any proceeds or other consideration is generated and prior to any transfer, sale, or other disposition of the license." As such, TerreStar's noteholders had a valid prepetition lien on the economic value of the FCC license under

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Article 9 of the Bankruptcy Code, and Section 552, which addresses postpetition liens, was inapplicable.

The *TerreStar* court did not rule on Sprint's "equities of the case" arguments asserted in Count III of its complaint, because the factual record was insufficient to make a decision whether it would be inequitable for the noteholders to claim priority status on the economic value related to the FCC license. The *TerreStar* court did note that section 552(b)(1) of the Bankruptcy Code is designed to prevent secured creditors from receiving windfalls that may result when use of a debtor's unencumbered assets increases collateral value. Given the limited factual record, the *TerreStar* court refused to rule on that part of Sprint's complaint.

Finally, the *TerreStar* court rejected Sprint's subordination arguments that *TerreStar* could not have any interest in the FCC license – nor could the noteholders – if Sprint's reimbursement claim was not satisfied. The court's rejection of Sprint's subordination argument was consistent with earlier rulings by the FCC whereby the FCC refused to make full reimbursement of Sprint's claim a condition for *TerreStar*'s use of the license.

Thus, this decision of the United States Bankruptcy Court for the Southern District of New York confirms that it is permissible for a lender to demand and obtain a lien on the economic value of an FCC license, although a lender may not obtain a lien on the license itself. The *TerreStar* decision is consistent with the FCC's desire to

retain proper regulatory controls over the sales, assignments, and transfers of FCC licenses. It also enables lenders to extend credit to holders of FCC licenses without the worry that the debtor's often most valuable asset (an economic interest in an FCC license) will be excluded from their collateral package.

Sharon L. Levine, Member of the Firm, Wojciech F. Jung, Counsel, and Thomas Livolsi, Associate, practice in Lowenstein Sandler's Bankruptcy, Financial Reorganization & Creditors' Rights Group. They may be reached by calling 973-597-2500 or via email at slevine@lowenstein.com, wjung@lowenstein.com, and tlivolsi@lowenstein.com.

1 - *Sprint Nextel Corp. v. U.S. Bank Nat'l Ass'n. (In re TerreStar Networks, Inc.)*, Adv. Proc. No. 10-05461 (Bankr. S.D.N.Y. August 19, 2011), available at www.nysb.uscourts.gov.

2 - *Spectrum Scan LLC v. Valley Bank & Trust Co. (In re Tracy Broad. Corp.)*, 438 B.R. 323 (Bankr. D. Colo. 2010), *appeal docketed*, No. 10-CV-02522 (D. Colo., Oct. 15, 2010).

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New York

1251 Avenue of the Americas
New York, NY 10020
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590 Forest Avenue
Palo Alto, CA 94301
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65 Livingston Avenue
Roseland, NJ 07068
973 597 2500