

10th Circ. Has Left Less Static For Secured Creditors

Law360, New York (January 02, 2013, 2:44 PM ET) -- On Oct. 16, 2012, the Tenth Circuit reversed the U.S. Bankruptcy Court for the District of Colorado and U.S. District Court for the District of Colorado and held that a creditor bank had a valid security interest in the proceeds of a future sale of a federally issued broadcast license. The Tenth Circuit's decision mends a split among the lower courts and provides additional assurance for creditors who take a security interest in the proceeds of broadcast licenses.

Tracy Broadcasting Corporation, a Nebraska corporation, operated a radio station in Wyoming under a license issued by the Federal Communication Commission. In May 2008, Tracy Broadcasting received a loan from Valley Bank & Trust Company, secured by various assets. Part of the collateral package securing the loan included Tracy Broadcasting's general intangibles and the proceeds from any sale thereof. In early 2009, Spectrum Scan LLC obtained a \$1,400,000 judgment against Tracy Broadcasting in Nebraska federal court. In August 2009, Tracy Broadcasting filed a Chapter 11 petition in bankruptcy court in Colorado.

The two primary creditors in Tracy Broadcasting's bankruptcy were Spectrum, an unsecured creditor, and Valley Bank, a secured creditor. Liabilities included on the schedules to the bankruptcy petition totaled over \$3 million and the value of the assets listed was slightly more than \$1 million. Tracy Broadcasting's most valuable asset was its FCC license, with an estimated value of \$950,000. On the schedules to the petition, the proceeds of the license were designated as "secured to Valley Bank."

Spectrum brought an adversary action in order to determine the extent of Valley Bank's interest in the license. The bankruptcy court ruled that Valley Bank had no security interest in the proceeds of a sale of Tracy Broadcasting's license. *Spectrum Scan LLC v. Valley Bank and Trust Co. (In re Tracy Broadcasting Corp.)*, 438 B.R. 323 (Bankr. D. Colo. 2010). The United States District Court for the District of Colorado affirmed the bankruptcy court's ruling. *In re Tracy Broadcasting Corp. (D. Colo. 2011)*.

FCC Licenses as Collateral

Section 301 of the Federal Communications Act (FCA) explicitly states that no license issued “shall be construed to create any right, beyond the terms, conditions and periods of the license.” 47 U.S.C. Section 301. Section 310 of the FCA prohibits the transfer of a license, and any rights thereunder, without the approval of the FCC. 47 U.S.C. § 310(d). Based on its interpretation of the relevant provisions of the FCA, it was the FCC’s position that no lien could be placed on an FCC license whatsoever.

The issue was litigated in federal court twice between 1992 and 1993, with the Seventh Circuit ruling that a lien on FCC licenses was invalid because the “FCC has consistently and unequivocally refused to recognize such interest” and the bankruptcy court for the District of Maryland determining that a creditor was able to perfect a security interest in “proprietary rights in the license vis-à-vis private third parties.” See *In re Tak Commc’ns Inc.*, 985 F.2d 916, 918 (7th Cir. 1993); *In re Ridgely Commc’ns Inc.*, 139 B.R. 374, 379 (Bankr. D. Md. 1992).

Following these two incongruent decisions, the FCC issued a ruling in 1994 stating that while a lien on the license itself interfered with the FCC’s right to regulate and approve licensees — because a secured creditor could foreclose and the rights to the license would transfer without FCC approval — a lien on the proceeds of the sale of a license did not raise the same concern. *In re Cheskey*, 9 FCC Rcd. 986, 987 (1994).

Proceeds of Collateral

Section 9-102(a)(64) of the U.C.C. defines “proceeds” as

- (A) whatever is acquired upon the sale, lease, license, exchange, or other disposition of collateral;
- (B) whatever is collected on, or distributed on account of, collateral;
- (C) rights arising out of collateral. U.C.C. Section 9-102(a)(64).

Section 552(b) provides the exception to 552(a)’s prohibition against security interests in after-acquired property with respect to proceeds. If a creditor has a valid security interest in prepetition property owned by the debtor, it will have a security interest in proceeds of that property as well, even if the proceeds are acquired post-petition.

The cases that have rejected a creditor’s rights to proceeds from the sale of an FCC license have reasoned that because an FCC license cannot be subject to a security interest, it is not “collateral,” and any consideration received from the sale and transfer of a license cannot be considered “proceeds” under the U.C.C. *In re Tak Commc’ns Inc.*, 138 B.R. 568, 577 (W.D. Wis. 1992).

The bankruptcy court accepted that Tracy Broadcasting had a private right to the proceeds from a sale of its FCC license, but determined that the right did not exist pre-petition because any such right, without an existing agreement to transfer and FCC approval, was too remote. *In re Tracy Broad. Corp.*, 438 B.R. at 330.

The bankruptcy court looked at the provision of the FCA which bars the transfer of an FCC license or any rights thereunder without FCC approval and found that the only interest in the license that Tracy Broadcasting had prepetition, and in turn could effectively convey to Valley Bank, was the right to receive proceeds upon an FCC-approved transfer of the license.

Further, according to the bankruptcy court, the right did not exist prepetition because it was contingent on an agreement to transfer the license and the FCC's approval of such transfer, neither of which occurred prior to Tracy Broadcasting filing its Chapter 11 petition. Any right to proceeds that would arise as a result of an agreement to transfer the license and approval by the FCC would become after-acquired property of the debtor. Accordingly, any transfer of Tracy Broadcasting's right to the proceeds of a transfer or sale of its license to Valley Bank was prohibited by Section 552(a). The district court agreed.

The Tenth Circuit's Decision

In its review of the bankruptcy court's decision, the Tenth Circuit divided its analysis into two steps, the first being to identify what, if any, interest Tracy Broadcasting could convey in its license at the time the loan was made by Valley Bank. To begin, the Tenth Circuit turned to the FCC's view of the purposes of the FCA as a whole. In accordance with the provision relied upon by the bankruptcy court in its analysis, the court acknowledged that the FCC has consistently held that a licensee cannot give a private party a lien on its license that would enable the lien holder to foreclose on the lien and circumvent the FCC's approval rights of any transfer of the license. 47 U.S.C. Section 310(d).

However, the court also pointed out that the FCC has said that granting a security interest in the proceeds of the sale of the license is not prohibited, and would in fact improve a licensee's access to necessary capital. Further, the court reasoned, while it is clearly within the government's purview to regulate the airwaves themselves, nothing in the FCA prohibits the licensee's private interest in the rights and value created by the licensee's use of those airwaves, value that is realized upon a sale of the license. The court rejected Spectrum's argument that the plain meaning of the applicable FCA provisions prohibited parties from possessing any private rights in FCC licenses.

Central to the court's analysis is the fact that the FCC recognizes that a licensee has a "right to the proceeds of a license sale and in the proceeds of that right." The court emphasized this distinction throughout its decision, as well as its position that the FCC's use of the phrase "security interest in the proceeds of the sale" is not limiting. Instead, the phrase simply means that a secured creditor cannot realize any money on its security interest until the license has been sold. This is important because if the security interest was only in the sale proceeds, it could not attach prior to a sale. Any holder of such interest would have no priority over any other creditors if the sale did not occur prepetition, reducing its value to a creditor. However, the right to receive proceeds from a future sale is a right that exists as soon as the licensee obtains its license and can be effectively conveyed to a creditor at such time, as well.

Having decided that Tracy Broadcasting had the right to the proceeds of a future sale of its license and in turn was able to grant a security interest in that right to Valley Bank, the Tenth Circuit turned to its second part of its analysis: whether such interest was a property interest that could attach before a sale of the license was contemplated.

Under Neb. Rev. St. U.C.C. Section 9-203, a security interest attaches to collateral when it becomes enforceable against the debtor. A security interest is enforceable against the debtor if the debtor has rights in the collateral. In the court's view, to hold, as the bankruptcy court did, that a licensee's right to the proceeds of a future sale of the license does not constitute "rights in the collateral" would be against both the FCC's policy and Nebraska's as well. The court emphasized again the FCC's view that giving licensees the ability to grant liens on the proceeds of the sale of their licenses provides them with necessary access to capital, making it a right that is also an article of commerce.

Furthermore, a revision to Neb. Rev. St. U.C.C. Section 9-408 in 2000 overrode state licensing laws that would bar the creation, attachment and perfection of security interests in state-issued licenses that are very similar to the type claimed by Valley Bank, recognizing that security interests in the proceeds of licenses can be created, attached and perfected. By comparing the footnote language of Neb. Rev. St. U.C.C. Section 9-408, which states that "by making available previously unavailable property as collateral, this section should enable debtors to obtain additional credit," to the FCC's statements with respect to access to capital, the court concluded that the goals of the FCC and the UCC were the same.

In addition, 9-408(c) and (d) permit a lien on a state license that is the same as the type of lien allowed by the FCC — a lien in the right to the proceeds of a license so long as the governmental interest in regulation of the license is not impacted. The court rejected as illogical the view that Nebraska law would prohibit the attachment and perfection of an interest in the right to the sale proceeds of a license that was issued by the federal government, but allow the attachment and perfection of an interest in one issued under state law.

Satisfied that Tracy Broadcasting had rights in the proceeds of a sale that were granted to Valley Bank prepetition, and that such rights attached under state law prior to any proposed sale, the Tenth Circuit remanded the case to the bankruptcy court for further proceedings consistent with its decision.

The Tenth Circuit's decision is consistent with decisions in other courts, including Sprint Nextel Corporation v. U.S. Bank National Assoc. (In re TerreStar Networks Inc.) (Bankr. S.D.N.Y. Aug. 19, 2011). While the issue may not be entirely put to rest, lenders will have more certainty going forward about the validity of their security interest in the proceeds of broadcast license sales.

--By Douglas R. Gooding, John F. Ventola and Dallas Nicole Cruz, Choate Hall & Stewart LLP

Douglas Gooding is chairman of the finance group at Choate Hall & Stewart LLP. John Ventola is a partner in the firm's finance group and Dallas Cruz is an associate in the group. They are based in the firm's Boston office.

The opinions expressed are those of the authors and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.