

SCOTUS Lets Stand Security Interest in Proceeds of Bankruptcy Transfer of FCC License

On May 13, 2013, the Supreme Court declined to review the ruling of the United States Court of Appeals for the Tenth Circuit¹ that had held that a security interest may extend to the “proceeds” of the future transfer of a license holder’s interest in its Federal Communications Commission (“FCC”) broadcast license and that, under applicable state law, the security interest attached upon execution of the security agreement, despite the fact that the parties did not contemplate a transfer of the license at that time. The Supreme Court’s ruling means that the Court of Appeals’ decision remains good law.

I. Background and Procedural History²

Tracy Broadcasting Corporation (the “Debtor”) owned a radio station that it operated under an FCC license, and FCC approval was required for a transfer of the license. In May 2008, Valley Bank and Trust Co. (the “Bank”) issued a loan to the Debtor, and the Debtor executed a Promissory Note, secured by a Commercial Security Agreement between the Bank and the Debtor, that granted the Bank a security interest in the Debtor’s “general intangibles” and the proceeds thereof.

In August 2009, the Debtor filed a petition for relief under Chapter 11 of the United States Bankruptcy Code, and in the context of a declaratory judgment action, both the United States Bankruptcy Court for the District of Colorado and the United States District Court for the District of Colorado found that the Bank did not have a valid, perfected security interest in the Debtor’s FCC license.

II. The Court of Appeal’s Decision

The United States Court of Appeals for the Tenth Circuit reversed the lower courts and held that even though the parties agreed that the Bank did not have a valid security interest in the FCC license itself because an FCC license cannot be subject to a security interest, the Bank could have a security interest in the proceeds of the transfer of such license.³ Several cases⁴ have permitted a license holder to confer a security interest in the proceeds of an FCC-approved transfer of a license, as opposed to the license itself, in limited circumstances.⁵ Under this line of reasoning, the holder of an FCC license has both “public rights” and “private rights.”⁶ The

¹ *In re Tracy Broad. Corp.*, 696 F.3d 1051 (10th Cir. 2012) *cert denied*, 12-1071, 2013 WL 775375 (U.S. May 13, 2013), available at <http://www.ca10.uscourts.gov/opinions/11/11-1453.pdf>.

² Most of the background facts regarding the issues raised in the case can be found in our prior client update, entitled *In re Tracy Broadcasting Corp.: Court Prohibits Bank’s Security Interest*, dated January 21, 2011, available at <http://www.cahill.com/publications/communications-alerts/100261>.

³ *Id.* at 1054 (explaining that a security interest cannot exist in the license itself because the FCC must approve all license transfers and that if the security interest holder foreclosed upon the license, the parties could not affect a license transfer without FCC approval).

⁴ See, e.g., *In re Ridgley Commc’ns, Inc.*, 139 B.R. 374, 377 (Bankr. D. Md. 1992); *MLQ Investors, L.P. v. Pacific Quadracasting, Inc.*, 146 F.3d 746, 748 (9th Cir. 1998); *In re Cheskey*, 9 F.C.C.R. 986, 987 (1994).

⁵ The Bankruptcy Court presumed, without deciding, that the FCC permits license holders to grant security interests in the proceeds of FCC-approved license transfers. *In re Tracy Broad. Corp.*, 438 B.R. at 328. The Court of Appeals expressly found that the FCC permits such security interests. *In re Tracy Broad. Corp.*, 696 F.3d at 1055. The Court further noted that the FCC had an interest in improving licensees’ access to capital and that permitting the grant of such security interests effectuates that goal. *Id.* at 1061.

⁶ *In re Tracy Broad. Corp.*, 438 B.R. at 328.

license holder's right to transfer its license, subject to FCC approval, is a public right, while the holder's "right to receive remuneration for a transfer" of the license is a private right⁷ in which the holder may grant a security interest because these rights do not interfere with the FCC's regulatory role. A license is considered a "general intangible," and proceeds from its transfer are thus deemed the proceeds of that "general intangible." The Court ultimately adopted this public/private distinction, while accepting the notion that a license holder can grant a security interest in its private right to receive proceeds of the license transfer.

The Court then turned to the Bankruptcy Code's treatment of such a security interest. Section 552(a) of the Bankruptcy Code sets forth the general rule that "property acquired by the estate or by the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case." An exception to this rule is that, if the debtor entered into a pre-petition security agreement, and if the ensuing security interest "extends to property of the debtor acquired before the commencement of the case and to proceeds . . . of such property, then such security interest extends to such proceeds . . . acquired by the estate" post-petition.⁸

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. . .⁹

The Court of Appeals treated the nature of the security interest as an interest "in the licensee's right to the proceeds of a license sale and the proceeds of that right. . . ."¹⁰

After concluding that the Debtor could grant a security interest in its right to the proceeds from the transfer of its license, the Court went on to consider "whether such a security interest is a property interest that can attach before a sale of the license is contemplated." The Court concluded that whether the Debtor had a property interest in the proceeds of a future transfer of the license was a matter of state law and held that, under Nebraska law, the "interest in the right to proceeds of a sale of an FCC license [attaches] when the licensee enters into a security agreement."¹¹

III. Significance of the Decision

Although the *Tracy Broadcasting* decision is only binding within the Tenth Circuit (Colorado, Kansas, New Mexico, Oklahoma, Utah, and Wyoming), the logic of its reasoning has already been adopted by other courts. For example, prior to the Court of Appeals' decision in *Tracy Broadcasting*, the Bankruptcy Court for the

⁷ *Id.* (citing *MLQ Investors, L.P.*, 146 F.3d at 748); see also *In re Application of Walter O Cheskey, Tr.-in-Bankr. for N.C.P.T. Cellublar, Inc. (Assignor) & Triad Cellular L.P. (Assignee)*, 9 F.C.C.R. 986 (1994); *In re Ridgely Commc'ns, Inc.*, 139 B.R. 374 (Bankr. D. Md. 1992).

⁸ 11 U.S.C. § 552(b).

⁹ U.C.C. § 9-102(a)(64).

¹⁰ *In re Tracy Broad. Corp.*, 696 F.3d at 1056. The Court further stated that a security interest directly in the proceeds of the sale could not exist until the sale was effectuated and those proceeds existed. *Id.*

¹¹ *Id.* at 1060.

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Southern District of New York upheld a lien on an interest in the proceeds of an FCC license in *In re TerreStar Networks, Inc.*¹²

The *Tracy Broadcasting* decision clearly affirms that lenders may receive and get the benefit of security interests in borrowers' private rights to proceeds from future sales of FCC (and presumably other similarly-regulated) licenses. Furthermore, the decision clarifies that such interests will attach at the time the parties enter into security agreements. This preserves the bankruptcy priority of the security interest holder's claim and supports telecommunications financing. Nevertheless, *Tracy Broadcasting's* reasoning clearly relies on applicable state law to define the property interest and identify when it may attach, so parties structuring similar security interests may need to refer to governing state law and relevant precedents within the applicable jurisdiction.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Chérie R. Kiser at 202.862.8950 or CKiser@cahill.com; Joel H. Levitin at 212.701.3770 or jlevitin@cahill.com; or Richard A. Stieglitz Jr. at 212.701.3393 or rstieglitz@cahill.com.

¹² 457 B.R. 254 (Bankr. S.D.N.Y. 2011), available at http://www.nysb.uscourts.gov/opinions/shl/208183_69_opinion.pdf. In *TerreStar*, the debtor/license holder issued notes secured by the economic value of its license. When the license was sold during bankruptcy, the unsecured creditors challenged the noteholders' security interest. The unsecured creditors argued that since a security interest could not attach directly to the FCC license, the security interest also could not attach to the license proceeds. Alternatively, the unsecured creditors argued that a security interest in post-petition proceeds violates Section 552 of the Bankruptcy Code. The bankruptcy court's logic mirrors what the *Tracy Broadcasting* Court would later decide: first, the noteholders had a valid security interest on the license's economic value, and second, under New York law, the security interest attached pre-petition, thereby avoiding any conflict with Section 552 of the Bankruptcy Code.

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