

**SOUTHERN DISTRICT OF NEW YORK BANKRUPTCY  
COURT HOLDS THAT CREDITORS CAN HOLD A VALID LIEN  
ON THE ECONOMIC VALUE OF FCC LICENSES**

In a recent decision, Judge Sean H. Lane of the Southern District of New York Bankruptcy Court held that secured noteholders of TerreStar Networks, Inc. and certain of its affiliates hold a valid lien on the economic value of TerreStar's Federal Communications Commission licenses, notwithstanding well-established federal law prohibiting a secured creditor from having a lien on an FCC license itself.<sup>1</sup> Importantly, Judge Lane also rejected any interpretation of FCC rulings that would direct the adjudication, priority, or validity of bankruptcy claims, as such claims issues lie within the exclusive jurisdiction of the bankruptcy court.

Background

TerreStar, a provider of mobile satellite services, holds various FCC licenses. Aware that federal law prohibits FCC licenses from being pledged as collateral, TerreStar's secured noteholders instead were granted a lien on the proceeds or economic value of the licenses.<sup>2</sup>

TerreStar's FCC licenses cover spectrum that was made available after Sprint Nextel Corporation cleared the underlying bandwidth in connection with its move from the 800 MHz spectrum to the more valuable 1990-1995 MHz spectrum. To ensure that Sprint was made whole for the cost of clearing the bandwidth, the FCC authorized Sprint to charge other licensees entering the cleared bandwidth for the cost of clearing the bandwidth, on a pro-rata basis.<sup>3</sup> In 2000, prior to Sprint's move and subsequent band-clearing, the FCC published a policy providing that "licensees who benefit from relocation of [incumbents] are responsible for

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<sup>1</sup> Sprint Nextel Corporation v. U.S. Bank National Assoc. (In re TerreStar Networks, Inc.), Case No. 10-15446 (SHL), Adv. Pro. No. 10-05461 (Bankr. S.D.N.Y. Aug. 19, 2011) (the "Decision").

<sup>2</sup> The security agreement for the senior secured 15% notes provided that the notes were secured by "all FCC License Rights . . . including all FCC Licenses, including, without limitation, 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 . . .*" Decision at 5 (citing Security Agreement [Dkt. No. 52, Exhibit C] § 3(f) (emphasis added)). Importantly, the security agreement carefully carved out the FCC license itself from the lien: "[S]uch security interest does not include at any time any FCC license to the extent (but only to the extent) that at such time the Collateral Agent may not validly possess a security directly in the FCC License pursuant to applicable federal law . . . but such security interest does include at all times all proceeds of the FCC licenses." Decision at 5 (citing Security Agreement [Dkt. No. 52, Exhibit C] § 3(f) (emphasis added)). The Offering Memorandum relating to the 15% notes likewise recognized that there was no lien on the S-Band license itself (and that the lien covered only the proceeds thereof) because only the FCC may determine who holds an FCC license. Decision at 5-6.

<sup>3</sup> Improving Public Safety Communications in the 800 MHz Band, 19 FCC Rcd. 14969 ¶¶ 261, 329-30 (2004); Decision at 6-7.

contributing [to the costs of relocation], as a condition to their licenses.”<sup>4</sup> In 2008, Sprint filed suit in the United States District Court for the Eastern District of Virginia against TerreStar and other licensees to recover the relocation costs allocable to such licensees.<sup>5</sup> At the request of the Virginia District Court, the FCC issued a ruling “tentatively” concluding that the licensees “have an obligation to share, on a *pro rata* basis, in the costs associated with the relocation of . . . incumbents.”<sup>6</sup> Then, on September 29, 2010, the FCC provided additional guidance regarding the licensees’ obligations to Sprint.<sup>7</sup> Among other things, the FCC: (i) clarified that the licensees (including TerreStar) were obligated to reimburse Sprint, (ii) rejected Sprint’s argument that the failure to pay reimbursement obligations should result in the automatic suspension of any FCC licenses, and, notably, (iii) concluded that Sprint’s “ultimate recovery against these . . . licensees ‘will be governed by the proceedings in the bankruptcy court, rather than by this Commission or in the district court case initiated by Sprint Nextel.’”<sup>8</sup>

After TerreStar filed for chapter 11 bankruptcy relief on October 19, 2010, Sprint filed proofs of claim for \$104 million of bandwidth-clearing costs allegedly allocable to TerreStar.<sup>9</sup> In addition, Sprint filed an adversary proceeding seeking a judicial determination that the noteholders had no liens on the economic value of TerreStar’s FCC licenses. If Sprint were successful, the substantial value attributable to TerreStar’s FCC licenses would be available for distribution to unsecured creditors of TerreStar (including, potentially, Sprint).

In July 2011, the Bankruptcy Court approved a sale of substantially all of TerreStar’s assets, including, subject to FCC approval, the FCC licenses.

### The Bankruptcy Court’s Ruling

#### *The Noteholders Hold a Valid Lien on the Proceeds of the FCC License*

In the Decision, Judge Lane first held that the TerreStar “noteholders have a valid lien on the economic value associated with TerreStar’s S-Band License, even if they cannot hold a lien on the FCC license itself.”<sup>10</sup> Judge Lane found support for this conclusion in case law addressing whether a lien can attach to an FCC license or any economic value associated with such

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<sup>4</sup> Amendment of Section 2.106 of the Commission’s Rules to Allocate Spectrum at 2 GHz for Use by the Mobile-Satellite Service, 15 FCC Rcd. 12315 ¶ 69 (2000) (the “2000 Ruling”); Decision at 7.

<sup>5</sup> Sprint Nextel Corp. v. ICO Satellite Service G.P., Civil Action No. 1:08-cv-651 (E.D. Va. 2008).

<sup>6</sup> Improving Public Safety Communications in the 800 MHz Band, 24 FCC Rcd. 7904 (2009) (the “2009 Ruling”) at ¶ 2.

<sup>7</sup> Improving Public Safety Communications in the 800 MHz Band, 25 FCC Rcd. 13874 (2010) (the “2010 Ruling”).

<sup>8</sup> Decision at 9 (citing the 2010 Ruling at ¶¶ 26-27, 73, 29).

<sup>9</sup> Sprint’s claim is disputed by TerreStar, but the validity, amount or priority of Sprint’s claim is not relevant to this decision.

<sup>10</sup> Decision at 16.

license.<sup>11</sup> Prior to 1992, the FCC took the position that a lien could not be placed on an FCC license in any manner. However, in 1994, in the wake of two federal cases reaching opposite conclusions regarding the extent to which creditors could hold liens on FCC licenses,<sup>12</sup> the FCC issued a declaratory ruling that granting a lien on the proceeds of the sale of a license does not raise concerns about secured creditors interfering with the FCC's licensing authority.<sup>13</sup> Judge Lane found additional guidance from the more recent Ion Media bankruptcy case, in which Judge Peck ruled that first lien lenders with a lien on a debtor's FCC licenses were entitled to the economic value of such licenses.<sup>14</sup> Persuaded by the reasoning in the FCC's 1994 declaratory ruling and related case law, Judge Lane concluded that the TerreStar noteholders had a valid lien on the economic value of TerreStar's FCC licenses.

Judge Lane also rejected Sprint's alternative argument under section 552(a) of the Bankruptcy Code, which provides generally that property acquired by a debtor postpetition will not be subject to prepetition liens. Specifically, Sprint argued that the noteholders' prepetition liens could not have attached to the proceeds of the licenses, which were generated by the postpetition sale of such licenses.<sup>15</sup> Sprint found support for its position in a recent Colorado bankruptcy court decision.<sup>16</sup> In rejecting Sprint's argument, Judge Lane determined that the Colorado decision was an outlier, based on his review of contrary case law from a variety of other jurisdictions and the 1994 FCC ruling discussed above.<sup>17</sup> Judge Lane also expressed concerns that adopting Sprint's interpretation of section 552(a) would unsettle secured creditors' expectations.<sup>18</sup> Judge Lane further noted that even in the unlikely event that section 552(a) applied in this context, section 552(b), which gives postpetition effect to after-acquired property clauses in security agreements, would have made the proceeds of the FCC licenses subject to noteholders' liens.<sup>19</sup>

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<sup>11</sup> Decision at 11-14.

<sup>12</sup> See In re Tak Commc'ns, Inc., 985 F.2d 916, 918 (7th Cir. 1993) (holding that an alleged lien on FCC licenses was invalid because the "FCC has consistently and unequivocally refused to recognize such interests"); In re Ridgely Commc'ns, Inc., 139 B.R. 374, 379 (Bankr. D. Md. 1992) (holding that creditor could perfect a security interest in the licensee's "proprietary rights in the license vis-à-vis private third parties").

<sup>13</sup> Decision at 14 (citing In re Cheskey, 9 FCC Rcd. 986 ¶ 8-9). Moreover "the FCC also referred to proceeds of a sale as the 'licensee's proprietary rights in the license vis-à-vis private third parties.'" Decision at 14 (citing In re Cheskey, 9 FCC Rcd. 986 ¶ 9 n.7).

<sup>14</sup> In re Ion Media Networks, Inc., 419 B.R. 585 (Bankr. S.D.N.Y. 2009).

<sup>15</sup> Decision at 18; Bankruptcy Code § 552 (" . . . 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.").

<sup>16</sup> In re Tracy Broad. Corp., 438 B.R. 323 (Bankr. D. Colo. 2010).

<sup>17</sup> MLQ Investors, L.P. v. Pacific Quadracasting, 146 F.3d 746, 749 (9th Cir. 1998); Urban Communicators PCS Ltd. P'ship v. Gabriel Capital, L.P., 394 B.R. 325, 335 (Bankr. S.D.N.Y. 2009); Wells Fargo Foothill, Inc. v. Kepler (In re Media Props.), 311 B.R. 244, 247 (Bankr. W.D. Wis. 2004).

<sup>18</sup> Decision at 23.

<sup>19</sup> Decision at 23 n.14.

*Judge Lane Asserts Bankruptcy Court's Jurisdiction Over Claims Disputes*

In its pleadings, Sprint asserted that FCC rulings provided a basis for invalidating the noteholders' liens on the FCC licenses. Sprint placed particular emphasis on an FCC ruling from 2000 providing that: "[s]ubsequently entering . . . licensees . . . will, as a condition of their licenses, compensate the first entrant on a *pro rata* basis, according to the amount of the spectrum the subsequently entering licensees are authorized to use."<sup>20</sup> Judge Lane found this decision unpersuasive for two reasons. First, Judge Lane noted that subsequent FCC rulings made clear that reimbursement obligations were not a condition for use of any FCC license. Second, and more importantly, Judge Lane looked skeptically upon the suggestion that the FCC could determine Sprint's claim in TerreStar's bankruptcy case, explaining:

*[I]t is the role of the Bankruptcy Court, not the FCC, to determine the priority of Sprint's claim vis-à-vis other parties' claims . . . .* The FCC recognized, instead, that Sprint's recovery for any reimbursement obligation "will be governed by the proceedings in the bankruptcy court, rather than by this Commission or in the district court case initiated by Sprint Nextel." The FCC further explained that "any [proceeding] by Sprint Nextel on a claim for monetary recovery against a debtor in [a bankruptcy proceeding] . . . is a matter for the Bankruptcy Court and is not addressed in this Report and Order and Declaratory Ruling." Indeed, the FCC noted that it is "not seek[ing] to determine the pecuniary interest of any individual debtor or creditor." There can be no dispute then that the FCC did not intend to determine the priority of Sprint's reimbursement claim in this bankruptcy.<sup>21</sup>

Furthermore, Judge Lane noted that the FCC's reluctance to determine the priority of claims was consistent with "the Supreme Court's view that the FCC's role as regulator of the telecommunications industry is distinct from the bankruptcy court's role as arbiter of claims disputes in bankruptcy."<sup>22</sup> Thus, Judge Lane's decision clarifies that claims adjudication is the exclusive province of the bankruptcy court, and bankruptcy judges will not be sympathetic to arguments that they should allow regulatory agencies to determine the relative validity and priority of competing claims.<sup>23</sup>

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<sup>20</sup> Decision at 29 (citing Memorandum of Law in Support of Plaintiff Sprint Nextel Corporation's Motion for Partial Summary Judgment [Dkt. No. 39], at 33 n. 12 (citing 2000 Ruling, ¶ 71)).

<sup>21</sup> Decision at 30-31 (citing the 2010 Ruling at ¶¶ 29, 79) (emphasis added).

<sup>22</sup> Decision at 31 (citing FCC v. NextWave Personal Commc'ns, 537 U.S. 293, 302-04 (2003)).

<sup>23</sup> The decision left one open issue in the case: whether section 552(b)(1)'s "equities of the case" doctrine, which allows a bankruptcy court to modify security interests, should be employed in this case to invalidate or subordinate the noteholders' lien to Sprint's claims. After discussing the narrow scope of the doctrine, Judge Lane commented that the doctrine likely does not apply to the facts of TerreStar's bankruptcy. Decision at 23-28. However, Judge Lane refused to grant the defendants summary judgment on this count because the factual record has not been fully developed. Decision at 27-28.

Observations

Judge Lane's decision should provide comfort to creditors whose security agreements grant liens on the proceeds of FCC licenses. These security interests will survive a bankruptcy filing, and put lienholders in their proper place in the front of the Bankruptcy Code's distribution scheme. The opinion further solidifies one of the telecommunication industry's most stable sources of secured financing. Holders of FCC licenses, and their potential lenders, can pursue financing arrangements that recognize the full value of FCC licenses, without facing or accounting for any uncertainty over the validity of such liens.

More broadly, this case reaffirms that the bankruptcy court, and not government regulators, will determine the priority, secured status, and amount of claims in bankruptcy cases. Arguments before a bankruptcy judge that a regulatory agency has already determined the status of claims will likely fall on deaf ears.

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August 29, 2011

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