WILMER, CUTLER & PICKERING

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January 14, 1999

TELECOMMUNICATIONS LAW UPDATES

SOLVENCY CERTIFICATIONS: THE FCC'S NEWEST EFFORT TO PROTECT ITS INTERESTS IN LICENSEE BANKRUPTCY PROCEEDINGS

After failing in 1997 and 1998 in its efforts to have Congress change the bankruptcy laws or amend the Communications Act to protect the FCC's interest in licenses won at auction, the agency has devised what it believes is the solution to its recent bankruptcy woes. As the FCC has learned (but never conceded) in wearing its creditor hat in the C Block PCS bankruptcies, it is by no means clear that the agency has the right to revoke licenses for nonpayment once the licensee has declared bankruptcy. Under section 525(a) of the Bankruptcy Code, 11 U.S.C. § 525(a), a government agency

> may not deny, revoke, suspend, or refuse to renew a license, permit, charter, franchise, or other similar grant to . . . a person that is or has been a debtor under this title or a bankrupt or a debtor under the Bankruptcy Act . . . solely because such bankrupt or debtor is or has been a debtor under this title or a bankrupt or debtor under the Bankruptcy Act, has been insolvent before the commencement of the case under this title, or during the case but before the debtor is granted or denied a discharge, or has not paid a debt that is dischargeable in the case under this title or that was discharged under the Bankruptcy Act.

Typically, section 525 has been held to be a defense against a government agency's efforts to deny a license because the debtor has defaulted on an unrelated government loan. The FCC license situation is different in that the payment is due on the licenses themselves, and payment is a condition of obtaining and maintaining the license. The FCC contends that payment of the license fee is simply a regulatory requirement not covered by section 525: According to the agency, the payment terms are a basic condition of the license, so that nonpayment should result in termination, regardless of whether the licensee is bankrupt. The Bankruptcy Code generally does not protect debtors from penalties for noncompliance with regulatory requirements that the government enforces via its routine police powers; for example, a debtor could not use its bankruptcy to shield itself from the obligation to file required FCC forms or avoid spectrum interference with another licensee, even if compliance requires the expenditure of funds that the debtor does not have on hand.

Despite taking this position publicly, the agency has at least implicitly recognized its inherent weakness: The FCC has made several well-publicized but unsuccessful efforts to have either the Bankruptcy Code or the Communications Act modified to "clarify" the FCC's right to terminate licenses for nonpayment. These efforts have been roundly criticized by the bankruptcy bar, which condemned the FCC's theory, its presumption that it has the right unilaterally to constrict debtors' rights in the face of the well-established protections in the Code, and its tactics of trying to secure such favorable legislation by way of budget or appropriations legislation that avoids Judiciary Committee review.

Not to be stopped, however, the FCC recently took advantage of a routine license assignment application to devise yet another solution to its section 525 dilemma. In late December 1998, the FCC announced the implementation of a "certification of solvency" requirement. Entities obtaining (by transfer or assignment) licenses on which installment payments (or theoretically any other type of payments) are due apparently now will be required to sign a certification "attesting to such matters as the effects of the licensee's assumption of the debt and other plans might have on

solvency and on its retention of reasonable amounts of capital to engage in business." *Order*, FCC 98-301, n.2 (released Dec. 23, 1998). In the FCC's view, obtaining this certification will "ensure that the government's rights arising from the licensee's binding obligation to repay the original bid price for the licenses . . . would not be unduly compromised in bankruptcy." *Id.* ¶ 1. The agency's theory is that approval of the license transfer or assignment would be made in reliance on the certification of solvency, and thus a bankruptcy filing would raise "serious questions . . . as to whether the assignee's certification of solvency constitutes a misrepresentation to the Commission, thereby raising further questions as to whether the assignees have the requisite character qualifications to remain Commission licensees." *Id.* ¶ 3.

This theory appears to be nothing more than an attempt to recycle the FCC's position that nonpayment of an FCC license debt is a regulatory matter rather than a debtor-creditor issue. Cancellation of a license because the debtor licensee becomes insolvent after giving a certification of solvency effectively would result "solely because [the] . . . bankrupt or debtor is . . . insolvent before the commencement of the case under this title." 11 U.S.C. § 525(a). But the FCC is hoping that the courts will respect its assertion that cancellation would in fact relate to the licensee's allegedly disingenuous certification, rather than the insolvency itself. This hope may be ill-founded, since what the FCC essentially is seeking is the kind of representation, warranty, or covenant that any typical lender would routinely ask for — the breach of which would give that lender a foreclosure right that generally would be suspended by the debtor's declaration of bankruptcy.

To revoke a license based on the allegation of "misrepresentation" to the agency with respect to the licensee's solvency, the FCC would have to hold a hearing under section 312 of the Communications Act. As with traditional financial representations to the agency, the FCC would have to have a reasonable basis for concluding that the certification was an intentional (or at least reckless) misrepresentation, not just a legitimate miscalculation. This seems no easy feat in the first instance. In the absence of extensive and detailed regulations, there undoubtedly will be many disputes about how to determine solvency, such as what assumptions were appropriate to make about market conditions, the time available to sell assets, and the like. Moreover, licensees (or potential licensees) seeking to protect themselves from such an allegation by the FCC would appear to have a ready solution. A company that has made (or is required to make) a certification of solvency could obtain an opinion from a financial advisor to the effect that the company is solvent in light of its balance sheet, its liabilities including the license obligations, the value of the licenses, and the relevant market conditions. While such an opinion would not be inexpensive, it could undermine FCC efforts to demonstrate intentional misrepresentation by the licensee with respect to "solvency." Investors in licensees that may be covered by the FCC's new requirement may want to consider requiring the licensee to pursue this option. In the long run, this new FCC "solution" to its uncomfortable status as a creditor may not be any more successful than its earlier ones.

This letter is for general informational purposes only and does not represent our legal advice as to any particular set of facts, nor does this letter represent any undertaking to keep recipients advised as to all relevant legal developments. For further information on these or other telecommunications matters, please contact one of the lawyers listed below:

Scott Blackmer	202-663-6167	SBlackmer@wilmer.com
Lynn Charytan	202-663-6455	LCharytan@wilmer.com
John Harwood	202-663-6333	JHarwood@wilmer.com
William Lake	202-663-6725	WLake@wilmer.com
William Richardson	202-663-6038	WRichardson@wilmer.com