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DC Circuit Decision Prods FCC to Revise Long-Standing Restrictions on Obtaining Security Interests in Licenses

For many years, access to capital for broadcasters has been handicapped by an FCC policy that bars the grant of security interests to banks or other creditors in FCC licenses. There is no dispute that any effort to enforce such a security interest in a way that would involve an assignment of the license (or a transfer of control over the licensee) would require prior Commission approval under Section 310(d) of the Communications Act of 1996 (the Act). However, the FCC's Media Bureau has long interpreted other provisions of the Act to extend much further, so as to bar the grant of such security interests entirely, and as a corollary to preclude any grant of a "reversionary interest" to a seller that has financed the sale of the station that would permit the seller to reacquire the license in the event of default. This policy derives from Sections 301 and 304 of the Act, which provide that no FCC license "shall be construed to create any right" beyond its terms, that a license confers rights to "use . . . but not . . . ownership," and that the license includes an express waiver of "any claim to the use of [the] particular frequency . . . as against the regulatory power of the United States."

The FCC's expansive reading of these provisions for broadcast licenses has long been criticized by both broadcasters and financial institutions as inconsistent with its decisions construing the same provisions more narrowly in granting assignments of licenses for unbuilt wireless systems, difficult to square with the Commission's award of licenses by auction and the permissibility of depreciating licenses under the tax laws, unnecessary to effectuate the requirement of FCC consent to assignments in the event of default, and at odds with the goals of encouraging investment in broadcasting and facilitating entry by new players. While the FCC opened a rulemaking in 1992 to address many of these concerns, until now that proceeding has remained dormant. The DC Circuit's recent decision in *Kidd Communications v. FCC,* No. 04-1247, 2005 U.S. App. LEXIS 22993 (D.C. Cir. Oct. 25, 2005), now brings the need for changes to FCC policy into sharp focus.

Kidd involved a challenge to an FCC decision approving a court-ordered assignment of a buyer's radio station license to the seller that had financed the purchase. The state court ordered the assignment, and directed Kidd (the original purchaser) to execute an FCC assignment application, in order to enforce the terms of a promissory note that required the parties "to act reasonably and in good faith to effect an orderly turnover of the station" to the seller in the event of default on the note. This right appeared to violate the FCC's ban on reversionary interests, which extends to any "right to reassignment of the license in the future" or "reserv[ation of] the right to

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use the facilities of the station." However, in an obvious effort to limit the scope of its prior policy, the FCC had found the ban inapplicable because the note had been executed two years after the sale, in connection with the settlement of later litigation. The FCC had further noted that limiting the scope of the reversionary interest doctrine was consistent with its policies of accommodating state court decisions and of insuring against loss of broadcast service to the public.

While recognizing that the FCC is entitled to significant deference in interpreting its own regulation, the DC Circuit concluded that these efforts at distinction were simply too creative. It pointed out that the FCC's historical defense of its policy had been based on the far more sweeping rationale that FCC licenses are not "a mortgageable chattel in the ordinary commercial sense," a rationale that had not previously been viewed as one that required accommodation to state law or to the need to avoid loss of service. In vacating and remanding the FCC's decision to grant consent to the assignment of the license back to the seller, the court found the agency's "awkward position" to be one of its own making, for failing—"through rulemaking or by adjudication"—to "explain adequately how it will reconcile state commercial and contract interests with its federal policies." This conclusion echoed the warning of one of the FCC's former staffers, who wrote in an oft-quoted article on this subject in 1991 that "the rules still exist and any change would have to follow an appropriate rulemaking proceeding to determine whether reversionary interests should be prohibited as a matter of policy."

The court's suggestion should provide the FCC with the necessary incentive finally to address these issues in the long dormant 1992 rulemaking proceeding. That proceeding arose out of two petitions for declaratory ruling. One asked the Commission to allow creditors to obtain security interests in broadcast licenses; the other asked the Commission to clarify the specific reversionary interest policy at issue in *Kidd*, so as to allow a seller to regain control of the license upon default, subject to Commission approval. The prospect of reopening this proceeding should be of significant interest to banks and other financial institutions that have historically sought but been unable to obtain security interests in licenses in connection with loans to FCC-licensed borrowers, except with respect to the proceeds of any sale.

Without FCC action in this proceeding, it will be impossible for creditors to obtain from communications firms the same kinds of traditional security interests in the full value of a debtor's business that they have no problem in obtaining in any other sector of the economy. As the Seventh Circuit concluded in a leading case in this area, *In re Tak*, 985 F.2d 916 (7th Cir. 1993), the FCC has "consistently and unequivocally refused to recognize" security interests in FCC licenses, and the question of whether to permit such interests is "a matter for the FCC rather than the courts to decide."

As financial institutions have argued, lifting this ban could significantly benefit the broadcast industry by increasing the availability and attractiveness of financing. Moreover, because the lack of a proven track record has long been viewed as a key obstacle for new entrants' ability to obtain financing and enter the broadcast business, providing greater security for lenders could prove to be of great help in promoting diversification of ownership in broadcasting. And as long as enforcement of security interests is made subject to FCC approval, changing this policy would not seem to conflict with any other policies of the Act. The FCC could, for example, continue to bar previous owners and holders of security interests from exercising any control over the operation of a station prior to obtaining such approval. On the other hand, the current policy favors unsecured creditors like program suppliers, who currently are not subordinated to secured lenders except to the extent of the value associated with the non-license assets of a station.

The result in *Kidd* now points very clearly

to the need for the FCC to address in a comprehensive way, consistently among all broadcast, wireless, and other licensed services, the problems that have long been recognized to flow from its unnecessarily stringent interpretation of the Act with respect to traditional security interests. Indeed, as the decision itself demonstrates, the agency has been straining to relax that view in order to accommodate the legitimate interests of creditors. By completing the work that it began on this issue thirteen years ago, the FCC could take a major step forward in promoting the availability of financing, at a critical time when the broadcasting industry faces rising DTV and programming costs and many more alternatives for its advertising customers.

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