Over the past several years, the Federal Communications Commission ("FCC" or "Commission") has auctioned strips of the electromagnetic spectrum to companies interested in providing wireless telephone personal communications services ("PCS"). This article focuses on the broadband PCS C-Block auction which was primarily limited to small business "entrepreneur" entities. The auction was designed to encourage the development of, and foster competition among, small, start-up wireless companies. In contrast to other auctions of PCS spectrum, the C-Block auction included bidding incentives, such as the ability to pay 90% of the debt on a low-interest installment basis, reduced up-front and down payment requirements, and the use of bidding credits.

Pocket Communications ("Pocket"), the second largest C-Block bidder, filed for bankruptcy in March 1997.¹ Prior to its filing, Pocket failed to make the first of its installment payments and upon filing, owed millions to the FCC.² Other C-Block bidders, including the fourth largest, National Telecom PCS ("NatTel"), have similarly defaulted over the course of the C-Block process, or are currently on the verge thereof. Most recently, in October 1997, affiliates of General Wireless, Inc., another large C-Block bidder, followed Pocket's lead and filed for bankruptcy.³ These incidents have raised issues of first impression and are of great concern because they threaten the integrity of the C-Block auction process, together with its goal of helping small businesses, and also threaten the federal government's collection of approximately $10 billion in auction proceeds which have already been included in the federal budget. This article discusses the legal and practical issues that might arise in the context of a PCS licensee's insolvency or bankruptcy filing, pursuant to which the FCC would be placed in the dual and conflicting role of regulator and first priority secured creditor.

BANKRUPTCY CONCEPTS

Bankruptcy courts have found licenses to be executory contracts.⁴ Although FCC licenses appear to have attributes of an executory contract, courts neither apply nor discuss executory contract law in dealing with the transfer of FCC licenses in bankruptcy.⁵ Instead, courts generally defer to

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³ An FCC license has the following attributes of an executory contract: (1) validity of the license is conditioned on the licensee's performance of its obligations under the license (including build-out requirements that are capital-consuming) and the related installment payment plan note and security agreement, as well as its compliance with the Communications Act of 1934, regulations and opinions of the FCC and of the Wireless Telecommunications Bureau, (2) the absence of any ownership rights by the licensee in the subject matter of the license, (3) the right of the FCC to cancel the license in the event the licensee does not perform, and (4) the requirement of FCC approval of any assignment of the license. See 47 U.S.C. §§ 301, 310(d) (1997); 47 C.F.R. § 1.2110(e)(4) (1996); see also Form Broadband PCS C-Block License [hereinafter License] (including, within its terms, all of the above "executory" items); Form Installment Payment
telecommunications law regarding restructure, or assumption and assignment of FCC licenses in bankruptcy and thus, have blessed such transactions, subject to FCC approval. For the most part, these cases have involved radio broadcast licenses. Transfer of a PCS license in bankruptcy, however, is an issue of first impression. Therefore, it is unclear in the case of these financially strapped C-Block licensees and, in view of the policy issues at stake, whether pertinent FCC rules and policy statements will be strictly enforced.

Most courts agree that, once an FCC licensee files for bankruptcy, its license becomes property of the bankruptcy estate (“estate”). Technically, an FCC license must be transferred to the debtor in possession (“DIP”) or trustee and, outside of bankruptcy, this transfer requires formal FCC approval. To expedite this transfer in bankruptcy, however, it is accorded pro forma approval by the FCC.

Once the license is in the hands of the DIP or trustee, the latter will generally attempt to create funds for the estate by offering the license for sale. If the licensee is in default, the FCC could theoretically cancel and thus, presumably re-auction the license. Such action would leave the debtor and its creditors with no recourse to the license, and possibly, with no recourse to any surplus proceeds of re-auction. In contrast, in the event of sale, surplus proceeds would likely be allocated to creditors. Although one court has held that cancellation of a license or per se refusal to approve its transfer constitutes a violation of the automatic stay created in bankruptcy, another court, in dictum, has expressed the opposite view. The tenuous authority of the FCC in this area is highlighted by attempts, over the last year, to draft legislation granting the FCC explicit authority to revoke and re-auction licenses of debtors in bankruptcy. In addition, at a June 1997 FCC forum on the subject of C-Block repayment, the Commission itself questioned its authority in bankruptcy proceedings.

Not surprisingly, therefore, when faced with a
situation of financial distress, the FCC has consistently expressed a preference for “market-oriented solutions” to the prospect of bankruptcy. FCC rules provide for work-outs between the FCC and a PCS licensee through the grant of grace periods and/or restructuring of payment plans. Since the inception of the C-Block process, the FCC has stated its willingness to grant a three to six month grace period for defaulting PCS licensees, during which time the licensee could maintain its construction efforts and/or operations while seeking funds to continue payments or seek from the FCC a restructured payment plan. The FCC has stated that it will evaluate requests for a grace period for defaulting PCS licensees, during the missed payment date, for a total of six months. In addition, the FCC encourages workout arrangements between the licensee and its outside lenders, stating that it would become involved only in transfer situations.

The availability of these out-of-court work-out opportunities presumes that, within a three to six month period, a PCS licensee would be able to procure financial backing sufficient to get itself back on its feet. This has not turned out to be feasible for the C-Block licensees. Therefore, a more flexible solution will be required if the FCC’s goal is to achieve a restructuring of C-Block debt. An alternative to restructuring would be the sale of such debt. Although the FCC has always been amenable to this work-out alternative, it has consistently indicated that any such sale would be conditioned on complete fulfillment of license conditions. This is likely to prove problematic for C-Block licensees. Accordingly, in the absence of a palatable restructuring proposal, these licensees are likely to opt for bankruptcy in the hope that FCC transfer requirements will not be strictly enforced by a bankruptcy court.

**TELECOMMUNICATIONS ISSUES**

In evaluating whether to approve a license transfer, the FCC must determine whether the licensee’s conduct, during the period in which it held the license, qualifies it for renewal of the license. In bankruptcy proceedings involving radio broadcast cases, the FCC has foregone this inquiry where benefits to creditors significantly outweigh benefits to a wrongdoer licensee. This is known as the “Second Thursday” doctrine. In addition, the FCC is required to consider the needs of public end-users. Nevertheless, the FCC is reluctant to approve transfers to licensees who are guilty of misconduct, leading to delays in approval of bankruptcy sales.

Upon renewal, a PCS license may be sold in

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17 *C-Block Letter, supra note 9, at 21573-75 (citing *In re Amendment of the Commission’s Rules to Establish New Personal Communications Services, Second Report and Order, 8 FCC Rcd. 7700 (1993) and Fifth Memorandum Opinion and Order, supra note 16, at 471).

18 See id.

19 Wireless Telecommunications Bureau Staff Responds to Questions About the Broadband PCS C-Block Auction, 78 Rad. Reg. 2d (P & F) 727, 729-50 (1995); see 47 C.F.R.
bankruptcy, subject to compliance with certain restrictions. In brief, these restrictions mandate that a transfer be made to a qualified transferee who assumes the payment obligations of the transferor. In bankruptcy, such rules may be waived by the FCC; however, full payment is nonetheless required. These provisions are designed to prevent "unjust enrichment" of the licensee, and in the C-Block context, require that principal and accrued interest be paid to the Commission at the time of transfer. Similar provisions require adjustments for any loss of eligibility to use bidding credits.

The FCC's full payment requirements appear to be in conflict with the bankruptcy policy favoring restructuring of debt and equitable distribution among creditors. While generally approving FCC license sales in bankruptcy, courts are silent on the issue of full repayment. This is because bankruptcy case law typically deals with the normal business failure of a radio station and focuses on the role and value of the license as part of an on-going concern. In contrast, the major issue in the PCS C-Block context is the licensee's inability to fulfill its financial obligations to the FCC. Although the case law is helpful in assessing how a court might treat an FCC license transfer in bankruptcy, it does not resolve the issues that may arise in the typical PCS C-Block case. Again, attempts to draft legislation strictly enforcing the FCC's full payment obligations in bankruptcy demonstrate the Commission's fear that they would not otherwise be enforced by a bankruptcy court.

**CURRENT ISSUES**

In light of these unknowns, and in order to salvage the C-Block process, the FCC has begun to relax its repayment rules, enforcing strictly only those requirements pertaining to the first half of the 10% down payment required of C-Block installment payers. Where this initial payment has not been timely made, the FCC has canceled and re-auctioned the license (as well as assessed default penalty payments). The FCC has been less strict concerning both the second part of the down payment and subsequently owed installment payments. With respect to the second down payment, the FCC has been flexible with respect to minor delinquencies which neither affect the timing of the auction, nor the FCC's review of the applicant's qualifications. For example, where the delay in payment has been short (ranging from one day to two weeks), and resulted from administrative error, the FCC has waived its right at 431; Ridgegley, 139 B.R. at 375; Smith, 94 B.R. at 221; Second Thursday #2, 25 F.C.C.2d at 115; see generally LaRose, 494 F.2d 1145 (D.C. Cir. 1974).

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26 See id. at §§ 1.2111(c), 24.711(c), 24.839(a) (1996); 97 Amendment, supra note 16, at 369-70.
27 47 C.F.R. § 24.711(c); see 97 Amendment, supra note 16, at 378.
28 47 C.F.R. § 24.712(b) (2); see 97 Amendment, supra note 16, at 378. In addition, the Note and Security Agreement require the payment of collection costs by a defaulting licensee regardless of bankruptcy. Security Agreement, supra note 5, para. 8(e); see Note, supra note 5.
29 See C-Block Letter, supra note 9, at 21574-75 (citing Fifth Memorandum Opinion and Order, supra note 16, at 471).
30 See, e.g., Atlantic, 994 F.2d at 1070; Fugazy #2, 124 B.R.
to cancel the license, charging a late fee instead.\textsuperscript{36}

With respect to installment payments, the FCC has frozen the pertinent deadlines, coincidentally doing so on the very day that Pocket filed for bankruptcy.\textsuperscript{37} At stake is nearly half of the $23 billion raised since 1994 when the PCS auctions began. The freeze was ordered pursuant to a formal request by certain licensees that the payment schedule be changed from quarterly to annual to facilitate their access to capital.\textsuperscript{38}

The FCC’s most recent and controversial endeavor in trying to keep the C-Block licensees out of bankruptcy is its adoption last September of a set of alternative solutions designed to strike a balance among the licensees’ varying needs, and still preserve the integrity of the auction process. These alternatives range from strict enforcement of FCC full payment rules to opportunities for buy-out and/or return of the licenses in exchange for a certain amount of debt forgiveness and attendant penalties.\textsuperscript{39} Criticism has already been voiced by interested parties, including some of the Commissioners themselves.\textsuperscript{40} In fact, the General Wireless bankruptcy filings exemplify the dissatisfaction of the licensees with these restructuring options. At publication, the FCC was seeking comment on the re-auction process that is contemplated by these options.

The repayment issues have been further complicated by antitrust concerns raised by various bidders through complaints and/or petitions filed with the FCC and in court, accusing rival companies of collusive actions to corner certain PCS markets.\textsuperscript{41} Some bidders are accused of using bidding signals to drive up the price for licenses sought by rival bidders. Yet another form of collusion has been alleged in a suit brought against Pocket in a New York federal district court just prior to its bankruptcy filing.\textsuperscript{42} In that suit, brought by NatTel against Pocket and others, the defendants are accused of diverting to themselves investment funds allegedly “earmarked for the plaintiffs.” NatTel is seeking damages of at least


\textsuperscript{37} See In re Installment Payments for PCS Licensees, DA 97-649 (1997).

\textsuperscript{38} See id.


The FCC order reinstates the deadline for making installment payments to Mar. 31, 1998 (one year from the date of the freeze) with the licensee being required to choose one of the following four alternative options by Jan. 15, 1998:

Option 1: Existing Note Obligations. Licensees may elect to continue making payments under their original installment payment plan notes in accordance with the terms of those notes and the Commission’s rules.

Option 2: Disaggregation. A licensee may elect to disaggregate one-half of its spectrum and return such spectrum to the FCC for re-auction. The licensee must disaggregate spectrum for all of the Basic Trading Area (“BTA”) licenses it owns within any Major Trading Area (“MTA”). In exchange, the licensee will have the proportionate half of its debt forgiven. One half of the downpayment will be applied toward the debt for the retained spectrum, while the other half will be forfeited. The licensee will be prohibited from rebidding for the returned spectrum or otherwise acquiring it in the secondary market for two years from the date of re-auction.

Option 3: Amnesty. A licensee may return all of its licenses, in exchange for which all of the licensee’s outstanding debt will be forgiven. Its downpayment will be forfeited. It will be permitted to bid on its returned licenses at re-auction, and there is no restriction on after-market acquisitions. An exception to the all-or-nothing requirement would be made as to licensees that have met or exceeded the five year build-out requirements by Sept. 25, 1997. These licensees may retain their built-out BTAs, but must also keep the other BTAs in the MTA where the build-out requirement has been met.

Option 4: Prepayment. A licensee may purchase any of its licenses at the face value originally bid by the licensee. The licensee must purchase all the BTA licenses it owns within any single MTA. The licensee may use 70% of its downpayment and any additional monies that it is able to raise to buy out its licenses; the remaining 30% of the deposit and any unused portion of the 70% will be forfeited. Licenses that are not prepaid must be returned for re-auction, in exchange for which the corresponding debt will be forgiven. The licensee may not rebid for the returned licenses or acquire them in the secondary market for a period of two years from the date of re-auction. See id.

See id.; Stephanie N. Mehta and John R. Wilke, FCC Plan to Aid Wireless Carriers Is Tougher Than Firms Hoped For, WALL ST. J., Sept. 26, 1997, at B5.


See id. The defendants were cited for “violation of the Sherman Act, breach of contract, tortious interference with contractual relations and fraud.” Id.
SECURITY INTEREST

Telecommunications law and policy does not permit the grant of a direct security interest in an FCC license to a third party because such a grant might endanger the independence of the licensee, as well as interfere with the FCC's plenary power to protect the public interest in the airwaves. The FCC permits the grant of a security interest in proceeds of an FCC authorized transfer, but it is generally subordinated to the FCC's first priority interest.

Additional security can be obtained by taking a security interest in the assets of the licensee's business and/or obtaining a pledge of its stock. Because the respective values of a license and related business assets tend to be maximized upon sale of the going concern, all of the above forms of security, taken together, would bring the lender as close as possible to having a security interest in the license itself. The value of the security would be further enhanced by the "bare license" policy of the FCC, pursuant to which the FCC will generally not approve the sale of a license without an accompanying transfer of the related facility's physical assets. Conversely, if the assets are somehow lost, taken over, or become inoperable, cancellation of the license could result. Moreover, the security interest in the sale proceeds will not survive if the license is canceled. Accordingly, although the FCC encourages the financing of PCS licenses by outside lenders, the FCC, acting in the role of both regulator and first priority secured creditor, ultimately controls the rights and remedies of all other creditors. These rights and remedies could range from collection of the full debt amount from the proceeds of a distress sale to loss of all rights in the collateral through cancellation of the license.

CONCLUSION

How the FCC will handle these issues is the principal question facing players in the wireless industry. The FCC seems concerned about the specter of bankruptcy filings by its C-Block licensees, despite both the historic deference accorded telecommunications law in bankruptcy proceedings and the fact that the FCC would enjoy the position of first priority secured creditor.

In attempting to keep its licensees out of bankruptcy, the FCC is encouraging distressed bidders to restructure under the September 1997 proposal — and to do so quickly. As the FCC now appears to recognize, a near-term resolution of this issue is necessary to attract capital and forestall the C-Block's loss of market share to larger wireless companies.


44 See id.

45 See Atlantic, 994 F.2d at 1074 (citing Smith, 94 B.R. at 221 (quoting In re Merkley, 94 F.C.C.2d 829-30 (1983))); 97 Amendment, supra note 16, at 368-69; C-Block Letter, supra note 9, at 21572-73.

46 97 Amendment, supra note 16 (citing C-Block Letter, supra note 9, at 21572); see Atlantic, 994 F.2d at 1074-75 (citing Ridgely, 139 B.R. at 378-79); Security Agreement, supra note 5, paras.1-2.

47 See Howard M. Liberman & Gerald Stevens-Kittner, Lending to Broadcast Stations-Part I, LOAN OFFICER’S LEGAL ALERT, 5, 6 (1989); Jack Whitley, A Primer on Commercial


49 See Security Agreement, supra note 5, para. 2.