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Regulatory Collateral: TerreStar, Tracy Broadcasting, AMR

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The market is abuzz regarding the potential outcomes for American Airlines bondholders whose obligations are secured by American's slots, gates and routes (SGR). As background, "slots" are authority granted by the Federal Aviation Administration to take off and land at certain airports during certain times. "Gates" are where passengers board and deplane at airports, and "routes" are authority granted by the Department of Transportation to use certain flight paths into airports.

In the past, SGR collateral has typically been included in broader financings covering aircraft, engines or spare parts. As extra collateral for these broader financings, it received little attention. In recent years, however, as some airlines' need for financing has outstripped their traditional collateral base, SGR has been used as stand-alone collateral for certain financings.

Gates are likely traditional leasehold interests and as such are governed by real property law. However, slots and routes are rights granted by the relevant regulatory authorities, and as such bring with them complexities not evidenced in more traditional collateral. For instance, an airline's right to use its slots and routes can be altered or revoked in certain circumstances. Because a borrower can only pledge rights that it holds, this complexity is viewed by some as leaving the door open to an argument that liens on American's slots and routes are unenforceable in American's bankruptcy cases.

Interestingly, the technical world of FCC financings may be instructive on the question of whether an airline may grant an enforceable lien on its slots and routes. In the past year and a half, two important—but conflicting—decisions have considered whether lenders had enforceable postpetition liens on the proceeds of FCC licenses. The better reasoned of the two decisions, *TerreStar*, held that they did, and it was written by Judge Sean Lane of the U.S. Bankruptcy Court for the Southern District of New York—the judge assigned to American's bankruptcy cases.

In relevant part, § 552(a) of the Bankruptcy Code provides that property acquired by a debtor postpetition is generally not subject to a lien created by a prepetition security agreement. Section 552(b) provides an important exception, permitting a prepetition security interest to extend to postpetition proceeds, products and offsprings of prepetition collateral (with certain exceptions). Therefore, to be enforceable postpetition, a prepetition lien must attach prepetition to an existing property right of the debtor.

Federal regulations prohibit the granting of direct liens on FCC licenses. However, to obtain the collateral value of such licenses, it is common practice for media companies to grant lenders liens on the proceeds of any disposition of such licenses. Additionally, such licenses are sometimes held by special purpose entities with equity interests pledged to lenders.

In *Spectrum Scan LLC v. Valley Bank and Trust Co.*, 438 B.R. 323 (Bankr. D. Colo. 2010) ("*Tracy Broadcasting*"), the U.S. Bankruptcy Court for the District of Colorado held that a creditor did not hold a valid prepetition security interest in the proceeds of an FCC license to be sold postpetition because two prepetition contingencies stood in the way of the disposition: (1) there was no agreement to transfer the license and (2) FCC approval would be required for any transfer. The court determined that the debtor did not have "sufficient [prepetition] 'rights in the collateral or the power to transfer rights in the collateral to a secured party,'" as required for a security interest to attach under UCC § 9-203. *Id.* at 330. The court essentially established a requirement that a sale agreement be reached and approved by the FCC prepetition for a lender to have a valid prepetition lien on the proceeds of the sale of an FCC license. The court admitted that "without [a] bankruptcy, a different result would obtain." *Id.*, n. 6. *Tracy Broadcasting* was affirmed by the Colorado district court.

In *Sprint Nextel Corp. v. U.S. Bank Nat'l Assoc.*, 457 B.R. 254, No. 10-15446 (SHL), 2011 Bankr. LEXIS 3217 (Bankr. S.D.N.Y. Aug. 19, 2011) ("*TerreStar*"), Lane flatly rejected the holding of *Tracy Broadcasting*, describing it as "fundamentally at odds" with the relevant case law and "ignor[ing] the sound reasoning" of courts that have recognized the distinction between the public rights associated with FCC licenses (to use airwaves), which cannot be pledged, and the private rights associated with such licenses (to realize their economic value), which can be pledged. *Id.* at 41.

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The court further explained that the hurdles established by *Tracy Broadcasting* "would make it difficult, if not impossible, for such a lien to survive the filing of a bankruptcy, notwithstanding the wealth of authority that such liens are permissible and the FCC's conclusion that such liens are desirable." *Id.* Lane argued that *Tracy Broadcasting* was an outlier and that generally "courts have uniformly recognized that an FCC license is a general intangible and that a lien on such an intangible may be perfected prepetition before any proceeds or other consideration is generated and prior to any transfer, sale or other disposition of the license." *Id.* at 31.

TerreStar's holding is not only correct but, as Lane pointed out, also reflects what market participants have long believed to be the case with respect to the proceeds of FCC licenses. Moreover, by analogy, *TerreStar* strongly supports the view that prepetition liens on at least the proceeds of slots and routes, if not the slots and routes themselves, should be enforceable as a postpetition matter. Like FCC licenses, slots and routes (and the disposition thereof) are subject to regulatory authority and contingencies beyond an airline's absolute control. However, just like the FCC license in *TerreStar*, these contingencies are better viewed as simply affecting the likely value of the collateral, rather than somehow affecting the enforceability of the debtor's prepetition pledge.

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