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Reception Unclear

Media Company Restructurings Present Unique Issues

by Dave Buzzell

Buffeted by economic and technological forces, broadcast media companies are struggling to stay afloat. Advertising revenue has been hard hit by both a faltering economy and a transformational shift to online media. The last few years have seen Chapter 11 filings by Citadel Broadcasting, NextMedia Group, Inner City Media, the Tribune Company, Young Broadcasting, ION Media, Equity Media Holdings, Media General, and Pappas Broadcasting, to name but a few. Many local stations are likewise succumbing to competition from the Internet or digital channels.

Despite their struggles, broadcast media companies have an invaluable asset – their broadcast license issued by the Federal Communications Commission (FCC). According to Adam Harris, partner at Schulte Roth & Zabel and head of the firm's business reorganization group, it is for this reason that most troubled media companies end up being restructured. "Very few media companies shut their doors and cease operating," he says. "If they have decent viewership or listenership, they continue to operate, but with a new capital structure and perhaps new owners. They are either consolidated into a bigger enterprise with a larger overhead and more revenue-generating assets, or they end up in the hands of a new owner with a better or less leveraged capital structure."

Restructuring a broadcast media company presents unique issues, however, for creditors and investors. "I would compare the challenges involved in a broadcast media company restructuring to those of a gaming company," says James Bentley, special counsel at Schulte Roth & Zabel. "There are some very specific issues that must be successfully navigated in restructuring a media company because of the FCC overlay. Licensing and tax issues, what you can and cannot get liens on – these all can potentially limit a creditor's ability to exercise rights. There's a whole series of very nuanced aspects to a broadcast company restructuring."

For example, the sale of a broadcast media company is never a simple transaction between the buyer and seller because transfer of the broadcast license requires FCC approval. Thus, what is normally a straightforward transaction can take months or even years to accomplish. If the sale is uncontested, the approval process generally takes one to three months. If, the sale is contested, it can be years before approval is granted or denied.

To keep the company from languishing while waiting for the FCC's imprimatur, one option for purchasers is to enter into a local marketing agreement, or LMA, with the seller/licensee, says David Hillman, a partner at Schulte Roth & Zabel. An LMA allows blocks of broadcast time to be sold to the prospective purchaser, who can then turn around and supply the station's programming and sell commercials, thereby generating revenue while awaiting FCC approval. Once approval is received, the LMA is terminated.

In a paper authored by Hillman and Bentley on media restructurings, they note a caveat to this strategy. Courts have generally held that secured creditors cannot obtain a lien on a broadcast license. However, courts are divided on whether secured creditors can obtain a lien on the proceeds of the sale of that license. Protecting a secured lender's security interest in the proceeds of a broadcast license sale is something to be taken in account

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when documenting prepetition loan agreements and working with borrowers in a restructuring.

They also note that broadcast media companies in bankruptcy often seek to deleverage the balance sheet by converting debt to equity under a reorganization plan. "Many broadcast companies took on a substantial amount of leverage pre-2008 and continue to struggle because of declining advertising revenue," Harris adds. "Companies that are pretty significantly leveraged up either try to consolidate, do acquisitions, or strike deals with equity holders."

Debt-to-equity conversions again entail FCC involvement, as the agency must approve any change in the direct or indirect equity ownership of the licensee. Thus, efforts to restructure a broadcast media company via a debt-to-equity conversion can become entangled in the same regulatory delays as an outright sale.

Hillman and Bentley offer that licensing approval delays can be overcome by using a liquidating trust – that is, the license is transferred to a liquidating trust pending FCC approval of the change in the equity ownership of the FCC licensee. A broadcast license can be temporarily transferred to a liquidating trust using a "short form" application that sidesteps what can be a lengthy public review period. Upon approval of the short form application by the FCC, the reorganized debtor issues beneficial interests in the liquidating trust to creditors who have agreed to take equity under the reorganization plan. The debtor can close the bankruptcy case once the broadcast license is transferred to the liquidating trust.

Final transfer of control of the broadcast license from the trust to the proposed purchaser requires the trust to file a "long-form" application with the FCC. The public has 30 days to comment on the license transfer, after which time the FCC may or may not approve the transfer. Again, however, the FCC is not bound by a limit on how long is has to grant or deny approval.

Transferring a broadcast license to a liquidating trust under a reorganization plan allows the debtor to confirm its plan without being held up by the FCC approval process. "The FCC and bankruptcy court have separate responsibilities," Hillman says. "The bankruptcy court is responsible for the plan of reorganization, to evaluate whether the company emerging from bankruptcy is a viable business. The FCC also considers the viability of a company that is going to take on a license, but that is only one of its considerations. Its primary concerns are things like concentration limits and foreign ownership restrictions."

Bentley and Hillman caution that transferring a broadcast license to a liquidating trust requires a well-drafted trust agreement and authorizations from not only the FCC and the bankruptcy court, but the IRS as well. For tax purposes, an IRS ruling on whether the trust qualifies as a liquidating trust must be sought.

Lastly, as mentioned above, the FCC is preoccupied with broadcast media ownership eligibility and concentration considerations. Failing to understand the agency's rules in this regard can undermine a restructuring. The FCC's ownership rules encourage market diversity and discourage foreign ownership: "The FCC really prefers to have local owners," says Hillman.

Thus, FCC rules limit the number of radio and television stations a single entity, or group of entities under common control, can own. Ownership limitations apply to both markets and across media platforms – for example, a entity that owns a newspaper may not also hold a broadcast license in the same market. Foreign ownership restrictions also apply. The FCC prohibits foreign entities from holding more than 20 percent of the equity of a licensee directly, and 25 percent of the equity of a corporation that controls the licensee.

"A broadcast license is very valuable," says Harris. "In some cases, it is the entire value of the company. It provides the licensee with the opportunity to generate revenue by virtue of having the ability to operate."

"Because licenses are so valuable, transfers can take a long time to work through in a restructuring," adds Hillman. "FCC approval is needed, and a contested sale adds to the complexity. We were involved in the restructuring of a media company in the Midwest where the existing owner raised every conceivable argument in an effort to derail the approval of the transfer. It takes time, even when objections are frivolous. In our experience, the long-form application can take years to get approved."

"There are some very specific issues attorneys need to be aware of in advising their clients in a media company restructuring," says Bentley. "Having the expertise and experience of having gone through it before is essential to a successful outcome. The cost of missteps can be much greater than in a traditional restructuring of a retailer, for example." ¤

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