Before the
Federal Communications Commission
Washington, DC 20554

In the Matter of Amendment of the Commission's Space Station Licensing Rules and Policies	IB Docket No. 02-34

COMMENTS OF INTELSAT LLC

Intelsat LLC ("Intelsat"), by its attorneys, welcomes this opportunity to comment on the Commission's Further Notice of Proposed Rulemaking on bond issues ("*Bond FNPRM*") in the above-captioned proceeding.[1] At the outset, Intelsat believes a bond requirement is an appropriate mechanism to discourage hoarding of orbital spectrum. Intelsat welcomes the Commission for issuing this *Bond FNPRM* to establish the final details of this new obligation. Toward this end, Intelsat believes that $5 million will ensure that the bond fulfills the Commission's expectations as an additional and meaningful incentive for milestone performance. Intelsat also does not object to the *option* of employing an escrow, provided that the FCC perfects a security interest in the escrow that will survive bankruptcy and asserts equitable subordination against any capital structure designed to evade financial forfeiture.

[1] *In the Matter of Amendment of the Commission's Space Station Licensing Rules and Policies*, FCC 03-102, IB Docket No. 02-34 (May 19, 2003) (First Report and Order and Further Notice of Proposed Rulemaking) ("*Bond FNPRM*").

I. THE STREAMLINED RULES MUST INCLUDE A FINANCIAL INCENTIVE FOR MILESTONE COMPLIANCE IF THEY ARE TO DETER SPECULATION

Intelsat supports FCC efforts to minimize the waste of orbital resources that would occur should mere speculators become (briefly) satellite licensees. The drawbacks of orbital "warehousing" include straightforward consumer welfare losses and increased opportunity and transaction costs for satellite operators. Moreover, speculation that ties up orbital resources hurts satellite manufacturers, which are forced to delay new spacecraft construction projects until a financially qualified entity is licensed.

Recognizing these dangers, the FCC considered, but rejected, the proposition that preparation costs and filing fees alone could suffice as a deterrent. (This is particularly true since the FCC essentially eliminated threshold financial qualifications years ago.) And, the FCC acknowledged in particular that its concomitant elimination of the no-trafficking-in-a-bare-license rule actually *increased* the likelihood of speculation as compared with the prior processing round environment. Plainly, therefore, the new streamlined satellite licensing rules must include some additional and meaningful financial incentive for milestone performance.

Moreover, whatever financial incentive is adopted must be carefully constructed so as to "survive" bankruptcy. If a license speculator that fails to perform could evade its forfeiture through bankruptcy, the bond would be no incentive at all.[2] Thus, the Commission's resolution of the issues raised in the *Bond FNPRM* should meticulously consider the real-world commercial impact of any change in current rules.

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[2] Intelsat notes that the rationale behind a financial bond or escrow is *not* the generation of revenue for the government. Thus, in some respects, it is relatively unimportant that the rules guarantee payment to the U.S. Treasury in the event of default. However, to achieve the deterrence desired by the agency, it is critical that the rules *minimize or eliminate any possibility* that bond or escrow funds could be *returned* to the applicant or its investors where milestones are not met.

II. A BOND AMOUNT OF FIVE MILLION DOLLARS IS APPROPRIATE

The Commission first seeks comment on the "appropriate bond amount."[3] Intelsat agrees that the forfeiture for failing to meet satellite milestones must be sufficiently high to deter speculators but not so high that it creates any undue burden on qualified and committed licensees. The practical effect of eliminating satellite financial qualification standards was that applicants obtained a license and then sought funding for a satellite system. In contrast, imposing an airtight financial forfeiture, however structured, will encourage applicants to obtain funding prior to or simultaneously with obtaining a license. Thus, establishing just financial consequences for failing to satisfy milestones will help ensure that financially capable satellite companies are licensed (in addition to encouraging more efficient use of spectrum/orbit resources, as explained above). Licensing more financially capable companies will help ensure that orbital resources are assigned to companies that actually intend to use them. However, none of these gains will accrue if the amount at risk is relatively insignificant; a financial incentive that is too small would be viewed as ineffective as none at all.

Were, for example, the incentive set at zero—something not at issue in the *Bond FNPRM*—entities (including individuals) would be able to speculate in licenses by risking only an approximate $100,000 filing fee plus application preparation costs. With its expenses limited to the relatively small expenditures of filing fees and preparatory costs, a company could obtain numerous bare licenses and freely seek to transfer them for profit. But, even were the threshold set slightly higher—say an additional $100,000 incentive for performance—there would be insufficient deterrent effect; given the potential returns, a speculator might be willing to double its bet.

3 *Bond FNPRM*, para. 334.

Given these factors, Intelsat believes that $5 million is an appropriate bond amount that will deter speculators without creating an undue burden on qualified and committed licensees.[4] A bond amount of $5 million will support the FCC's efforts to minimize the waste of orbital resources that would occur should mere speculators be permitted to acquire, albeit briefly, rights to satellite spectrum.

Five million dollars is also a reasonable bond amount when viewed against the costs of constructing a satellite. As the Commission has noted, the cost of constructing, insuring and launching a geostationary satellite is nearly $250 million.[5] The FCC's interim $5 million requirement (for geostationary satellites) thus amounts to a mere 2 percent of system costs. Reducing the bond amount would vitiate the deterrent effect. Given the amounts of capital necessary to become a satellite service provider, an incentive amounting to 2 percent of the costs of a single spacecraft is clearly not unduly burdensome.[6]

Moreover, a $5 million bond is commercially obtainable at a cost far below $5 million. Intelsat believes that a bond from a bona-fide U.S.-licensed surety company[7] could be obtained

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4 Intelsat initially proposed a $10 million bond amount. Comments of Intelsat LLC, IB Docket No. 02-34, at 10-12 (filed June 3, 2002); Reply Comments of Intelsat LLC, IB Docket No. 02-34, at 4-6 (filed July 2, 2003); *Bond FNPRM*, at para. 334.

5 *Bond FNPRM*, at para. 220; *See PanAmSat Licensee Corp., Application for Authority to Launch and Operate a Replacement C/Ku Hybrid Fixed Satellite Service Space Station at 95° W.L.*, Order and Authorization, 17 FCC Rcd 10483, 10485 (2002).

6 Intelsat notes that the streamlined rules already provide for automatic reductions of 25 percent per milestone (GSO), so the "costs" of canceling a satellite after construction is commenced already are even less than the initial $5 million (*e.g.*, $3.75 million before Critical Design Review ("CDR"); $2.5 million before launch). *Bond FNPRM,* Appendix B Rules Changes, p. 136 (amended regulations at 47 C.F.R. § 25.149 (d) to become effective Sept. 26, 2003).

7 The Commission should require licensees to obtain a bond from a bona-fide U.S. licensed bond company and may need to establish appropriate criteria for such a bond company.

for a small percentage of the face value of the bond per annum.[8] The fee could be even lower as sureties gain experience: the normal fees for performance bonds in the construction industry vary between 0.75 and 1.5 percent. Thus, the actual costs of bonding milestone compliance are relatively low.

III. AN ESCROW MUST BE STRUCTURED TO SURVIVE BANKRUPTCY

The Commission also seeks "comment on whether [the agency] should allow licensees to establish an escrow account as an alternative to posting a bond."[9] Intelsat supports this proposal, provided that: (1) escrow is an alternative option to bond, not a replacement; and (2) the FCC routinely perfects a security interest in the escrow that would survive bankruptcy.

A. The FCC Should Permit Escrows Only As A Licensee Alternative Option To Bonds

Intelsat does not object to permitting satellite licensees to create an escrow, rather than obtain a bond, to secure its financial obligations for failure to meet spacecraft construction milestones. However, the choice of escrow or bond should be left to the licensee. That is because an escrow could be more burdensome to a licensee than a bond and may, to some extent,

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8 For background purposes, Intelsat notes that bonds are used where one entity seeks to "guarantee" future acts to a second entity. A bond merely makes the third party secondarily liable for a specified sum should the first entity not meet its obligations and be unable to pay. The bond is issued by a third party (normally a surety company), and paid for by the entity making the guarantee. A surety acts similar to a bank, assessing first the creditworthiness of the entity seeking the bond and second the risks that the company will not perform. As a practical matter, a surety's assessment will depend on the financial strength of the company, the existence of sufficient assets that could "secure" the potential debt, and the "track-record" of the company's performance in similar circumstances. The third party surety then sets a fee for adding its creditworthiness to that of the licensee, charging the entity making the guarantee a non-refundable fee—less than the bond's entire value—calculated as a percentage of the bond amount. The bond is executed in favor of the entity obtaining the guarantee, but controlled by the surety until the task is completed or defaulted. In the former case, no further payment is owned; in the latter case the surety is liable to pay the beneficiary and typically has rights to recover its expenditure from the guarantor should the entity fail to complete its required actions.

9 *Bond FNPRM*, para. 335.

actually undermine the FCC's clear objective of encouraging construction of U.S. licensed spacecraft.

Escrows, unlike bonds, require the licensee to lock up the entire amount (*e.g.*, $5 million) *ab initio*, as opposed to some percentage of the amount (*e.g.*, 4 percent of $5 million) as set by the surety company. As such, funds committed to escrow cannot be used or transferred during the life of the escrow except to the extent the FCC permits the gradual reduction of the escrow amount. Thus, the escrow option could establish a *higher* barrier to entry. Moreover, because escrow funds are, by definition, unavailable to the licensee, the escrow monies could *not* be used to pay for satellite construction, insurance or launch. As a result, requiring satellite licensees to escrow their potential forfeiture would be arguably inconsistent with the agency's policy to encourage satellite construction and thus service to the public. Thus, licensees should be able to choose to employ either a bond or an escrow.

B. The FCC Should Perfect A Security Interest In An Escrow Account That Would Survive Bankruptcy

Moreover, for escrows to be an effective approach, any escrow agreement must be carefully constructed so as to "survive" bankruptcy and must have all the same characteristics of a bond that ensure that the escrowed funds are forfeited in the event of milestone non-compliance. Obviously, if a licensee could default on its milestones, declare (or be placed in) bankruptcy, and thereby avoid any financial consequences for its default, the escrow requirement might not deter a license speculator. Under most circumstances, a bond will be an effective deterrent, because the licensee remains liable in the event of default, and would be liable to the surety in the case of default followed by bankruptcy.[10] By contrast, an escrow account could be

[10] In a bond arrangement, the third party surety agrees, in exchange for the licensee's promise of indemnification or a lien on the licensee's assets, to become additionally liable, with a right of recovery against the licensee, to the claims of the FCC out of its own funds up to the

considered the property of a bankrupt licensee's estate and thus subject to automatic stay under §362 of the Bankruptcy Code.[11] If so, of course, the FCC would, as a minimum, have to "fight it out" in Bankruptcy Court to acquire the performance incentive, reducing the deterrent value of the escrow.[12]

To minimize the risk that a satellite licensee could avoid the intended consequences of failing to meet a milestone merely by filing bankruptcy, the FCC should take steps to perfect its security interest in the escrow account and prevent the assets of the account from being partitioned among the unsecured creditors. The FCC's interest in that funded escrow, under the UCC codes of most states, can be perfected by notice to the escrow agent maintaining the funds.[13] In addition, the escrow account agreement should specify that the licensee cannot exert

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amount specified in the bond in the event the licensee cannot meet its milestones and defaults under its license. Because it is a third party, and not the debtor, who has assumed liability with the creditor, the bond will normally not be considered property of the estate and will not be protected by the automatic stay. *See In re Lockard*, 884 F.2d 1171, 1178 (9th Cir. 1989); *citing* 8 C.J.S., Bankruptcy § 140 (1956). Section 105(a) of the Bankruptcy Code, 11 U.S.C. § 105(a), does give the court the equitable power over some non-estate property to facilitate reorganization of the bankrupt, which could be argued to cover a bond. *See Monarch Life Ins. Co. v. Ropes & Gray (In re Monarch Capital Corp.)*, 173 B.R. 31, 42 (D. Mass. 1994), *aff'd*, 65 F.3d 973 (1st Cir. 1995). However, most courts will not apply § 105(a) to a bond because the surety's obligations are independent and not derivative of the debtor. *See Lockard*, 884 F.2d at 1179.

11 *In re Missionary Baptist Foundation of America, Inc.*, 792 F.2d 502, 505 (5th Cir. 1986) (escrow account was property of the estate and the automatic stay prevented transfer of funds to the grantee).

12 Indeed, if the bankruptcy occurred before an order finding that the licensee missed its milestone became final, and the FCC had not perfected its security interest in the escrow account, it is conceivable that the FCC could be in the position of an unsecured creditor, effectively nullifying the policy behind the escrow.

13 *See In re Vienna Park Properties, L.P.*, 135 B.R. 739 (S.D.N.Y. 1991) (applying Virginia UCC, § 8.9-304(1)), *aff'd in part, rev'd in part,* 136 B.R. 43 (S.D.N.Y. 1992), *aff'd,* 976 F.2d 106 (2d Cir. 1992); *Appeal of Copeland*, 531 F.2d 1195, 1203-04 (3rd Cir. 1976) (escrow agent, acting for benefit of both parties, was a bailee with notice under N.Y. Code § 9-305 in that his possession perfected the creditor's security interest and satisfied notice requirement of UCC); *Matter of O.P.M. Leasing Services, Inc.*, 46 B.R. 661, 670 (Bankr. S.D.N.Y. 1985) (applying New York UCC law); *Matter of Barney*, 344 F. Supp. 694, 696 (D. Idaho 1972) (applying Idaho UCC law); *but see In re Arrow Mill Development Corp.*, 185 B.R. 190, 196 (D.N.J. 1995) (under

any direct control over the escrow account, which includes not being able to withdraw any funds without first seeking the FCC's permission.[14] Additionally, the FCC must be the party serving notice upon the escrow agent to release funds to the licensee. In practice, this means that any return of the escrow funds to the licensee as it meets its milestones, should not be "automatic" but only occur upon the direction of the FCC. Finally, the FCC should pursue equitable subordination against any capital structure designed to evade financial forfeiture.[15]

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New Jersey UCC law, the grantor held legal title to the funds subject to divestment upon fulfillment of the escrow condition; thus the grantor possessed legal title, was not a creditor and thus not required to perfect its interest under the UCC, section 9-305).

14 Intelsat notes that the FCC's past policy permits a licensee to directly withdraw interest from the escrow account at any time and withdraw principal upon meeting each milestone. While this practice does not affect the FCC's perfected interest in the escrow, it may have the effect under Bankruptcy Code § 541 of granting the licensee some beneficial interest in the estate. That interest would then constitute property of the estate and a grantee may not distribute or dispose of the escrow without court permission. *See In re Rosenshein*, 136 B.R. 368, 374 (S.D.N.Y. 1992).

15 Bankruptcy Code Section 510(c)(1), 11 U.S.C. Sec. 510 (c)(1), permits the court to: "subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest." *See Matter of Herby's Foods, Inc.*, 2 F.3d 128 (5th Cir. 1993) (insider's practice of advancing funds to the debtor only in the form of loans, at times when no *bona fide* third party lender would have done so, with full knowledge that the debtor was undercapitalized and insolvent, as well as the failure to record loans on the debtor's books, the failure to evidence other loans by any form of agreement, and the tardy perfection of some secured loans, supported equitable subordination). *See also In re Beverly-Russell, Inc.*, 201 B.R. 354 (Bankr. W.D.N.Y. 1996) (court equitably subordinated debt of company's purchasers).

IV. CONCLUSION

In view of the foregoing, the FCC should confirm its initial decision to require satellite licensees to execute a $5 million performance bond to guarantee compliance with spacecraft milestones. Intelsat has no objection to permitting licensees to guarantee compliance via an escrow account, at the licensee's option. If the Commission does authorize escrows, however, it should take all steps necessary to minimize the possibility that the escrow account could be swept into the licensee's bankruptcy estate should the licensee become bankrupt, including perfecting its security interest in the escrow and crafting standard escrow language further removing the account from the licensee's control.

Respectfully submitted,

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