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Cable Television Secured Financing*

By ROBERT G. WEISS**
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Recent figures indicate that in just the past few years several billion dollars have been loaned by banks, insurance companies and other lending institutions to finance the construction, expansion and operation of cable television systems.¹ The enormity of this financial commitment underscores the importance of lender's counsel mastering the rapidly changing business practices in the cable television industry.²

This article examines an extremely common form of cable television financing—one in which the lender funds the construction of a new or expanding cable television system and the operation of that system, and takes the system itself as collateral. The lender looks to the cash flow of the system as a source of repayment, and in the event of default, its primary, if not sole recourse, is to foreclose upon the system and its assets.³ Under these circumstances, the focus of lender's counsel

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1. Rothburt, *Big Time Borrowing*, CABLEVISION, May 24, 1982, at 55.

2. In view of the many technologies that provide services similar to cable television, a definitional statement may be in order. This article deals solely with a cable system, which involves programming through reception and re-transmission of signals received and processed at a local receiver (head end) and distributed by means of coaxial cable. Other related, but different technologies include: multi-point distribution service (MDS), direct broadcast satellite (DBS) and satellite master antenna television (SMATV or private cable), each of which involves reception of signals by microwave or satellite receivers at particular homes or apartment complexes, thereby avoiding the necessity of laying or stringing coaxial cable in the streets; low-power television (LPTV), involving limited power-and-range broadcast stations; and subscription television, involving the transmission of scrambled broadcast television signals. The nature of the collateral and lender's efforts to create an enforceable security therein will vary according to the different technologies of the various systems.

3. As noted in the text, this article deals with a situation in which the lender takes only the cable system's operating assets as security. No attempt is made to deal with the variety of other forms of collateral and guaranties that a lender may require. However, several common practices in this area may merit some mention. First, lenders sometimes find it useful to take a lien on the stock of the cable operator or, in the case

is twofold: (1) to assure, through appropriate documentation executed by the borrower and other parties, that in the event of default, the lender will be able effectively to enforce its security interest by foreclosing upon and then conveying the system to an appropriate buyer; and (2) to advise the client of, and to minimize, any legal impediments to the realization of the anticipated cash flow of the cable system. Before exploring how lender's counsel can accomplish these tasks, it is important to define the assets that are involved in a cable system.

I Defining the Collateral

Lender's counsel must understand the basic components of a cable system and the practical interrelationship among them. For these purposes, it is useful to divide a cable system's assets into tangible and intangible personal property, and real property.

A. The Tangible Assets

The tangible assets of the cable system generally consist of the equipment used in reception, processing and retransmission of television signals. Although cable systems vary substantially in design and complexity, a general outline of the major elements of a typical system is as follows:⁴

1. "Head-end" equipment, used for receiving, processing, filtering, mixing and converting the television signal, including one or more earth stations ("dishes"), antennas, microwave links, and various pieces of electronic equipment. The head-end is the nerve center of a cable system.
2. Trunklines and feeder lines, composed of coaxial cable (from which the name of the industry is derived), that are either strung along telephone poles, or laid underground, or both. The lines distribute the television signals from the head-end to the streets within the community being serviced by the system;

of a limited partnership, a lien on the partnership interests. Second, most cable system operators are multiple system operators (MSO's) and may therefore possess a number of highly valuable operating systems in addition to the one being financed. For this reason, many lenders seek cross-collateralization by obtaining a lien on other systems owned by the MSO.

4. Klein & Fleming, *Lending to the Cable Television Industry*, 64 J. COM. BANK LENDING 27, 30-31 (1982).

3. Amplifiers at various points along the cable that protect against attenuation (degradation of the signal);
4. Droplines which carry the signal from the feeder lines to individual residences;
5. Decoders or converters which allow the signal to be played on individual television sets;
6. Service equipment and vehicles;
7. Office equipment, including computers; and
8. If the system "cable-casts" (that is, produces its own programming), cameras and other studio production equipment.

B. The Intangible Assets

The intangible assets of a cable system generally consist of permits and other contractual and governmental rights needed to operate the system, rights to receive payment from subscribers, and perhaps trademarks. Most important of these assets is the franchise, which is necessary because the coaxial cable must run on, under or above public property. In most jurisdictions, cable systems are subject to the control of the city or other municipality in which the system is located, and it is therefore the municipality that must grant the franchise. However, in some locales this is the province of either the state or county government.⁵

In addition to the municipal franchise, the cable system operator will have other intangible assets. These intangible assets include consents from governmental and/or private utilities to string the coaxial cable along telephone or utility poles⁶ and agreements with apartment owners or condominium associations to enter their property. Another intangible asset is the cable system operator's right to receive payment from subscribers. Finally, the cable operator may own valuable trademarks or service marks in his business.

C. Real Property Assets

Operation of a cable system requires situating the "head-end" equipment which necessitates the use of real property. The cable system operator will generally have a fee or leasehold interest in the building at which the head-end is located.

5. Kinley, *Franchising*, in CURRENT DEVELOPMENTS IN CATV 1981 231-34 (1981).

6. Christensen, *Pole Attachments*, in CURRENT DEVELOPMENTS IN CATV 1981 65 (1981).

II Documentation

A. Documentation with the Borrower

Basic documentation for a loan to a cable operator will include a security agreement setting forth the tangible and intangible personal property. Tangible property would be classified as equipment,⁷ except for the decoders/converters, which are generally leased to the subscriber and are therefore classified as inventory⁸ under the Uniform Commercial Code (hereinafter the Code or the U.C.C.).⁹ The items of intangible property described above will be classified as general intangibles, except for the right to receive subscriber payments, which can be either accounts¹⁰ or chattel paper, depending on whether the obligation to pay for cable service is evidenced by a writing signed by the subscriber and otherwise meets the requirements for chattel paper under the Code.¹¹ Often, the obligation of subscribers to pay for the cable service is contained in a lease agreement covering the decoders/converters, and therefore would be classified as chattel paper.

U.C.C.-1 financing statements should be filed with respect to the tangible assets according to the laws of the states in which these assets are located—generally a central filing and perhaps a local filing will be involved.¹² Perfection of a security interest in the cable system service vehicles will generally be accomplished by appropriate registration with the state's motor vehicles department, and possession of the certificates of registration or ownership ("pink slips").¹³

U.C.C.-1 financing statements should also be filed with respect to the intangible assets according to the laws of the state in which the cable operator is "located," which the Code de-

7. U.C.C. § 9-109(2) provides that "goods are 'equipment' if they are used or bought for use primarily in business"

8. U.C.C. § 9-109(4) defines "inventory" as goods "held by a person for sale or lease or to be furnished under contracts of service"

9. U.C.C. § 9-109(4). References in this article are to the 1972 version of the UCC.

10. "'Account' means any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper, whether or not it has been earned by performance." U.C.C. § 9-106.

11. U.C.C. § 9-105(1)(b). "'Chattel paper' means a writing or writings which evidence both a monetary obligation and a security interest in or a lease of specific goods"

12. U.C.C. §§ 9-103, 9-401(1).

13. U.C.C. § 9-302(3)(b).

files as the borrower's "place of business if he has one, and his chief executive office if he has more than one place of business, otherwise at his residence."¹⁴ This will generally involve a central filing, and perhaps a local filing as well, depending on the state's requirements.¹⁵

Two of the types of intangible assets may require additional attention by lender's counsel. First, if there are trade or service marks of significant value, appropriate federal and state filings may be advisable.¹⁶ Second, if part of the lender's collateral consists of chattel paper, in addition to the U.C.C.-1 filings describing chattel paper, the lender should be advised either to take possession of all chattel paper or require that the cable operator place a legend on each piece of chattel paper reciting that it is subject to a security interest in favor of the lender. This additional requirement is advisable in light of the effect of U.C.C. section 9-308, which allows subsequent purchasers of chattel paper to gain priority over secured parties who perfect solely by filing, if those purchasers give new value, take possession of the chattel paper, and do not have knowledge that the specific chattel paper is subject to a security interest.¹⁷

The lender may well wish to be able to control and to convey the entire head-end in event of foreclosure, in which case it will be necessary for the lender to have a lien on the cable system's interest in the real estate on which the head-end is located. If the cable operator has a fee interest, a deed of trust or mortgage will be appropriate, depending on applicable state law. If (as is more often the case) the interest is a leasehold interest, applicable state real estate law should be consulted. Generally, the leasehold interest should be encumbered by a properly recorded leasehold deed of trust.

B. Documentation with Other Parties

1. The Municipal Franchise

The municipal franchise consists of the right to lay cable and operate a cable system for a fixed period of time in a fixed geographic area within the municipality. It is generally contained

14. U.C.C. § 9-103(3)(d).

15. U.C.C. §§ 9-103, 9-401(1).

16. See generally Lee, *Perfection of Security Interests in Intellectual Property*, in *PERFECTION AND ENFORCEMENT OF SECURITY DEVICES* 1979, 79-90 (1979).

17. U.C.C. § 9-308(a). If the only chattel paper involved consists of agreements with individual subscribers, the steps outlined in the text will likely be impractical.

in and granted by municipal ordinance. In addition to executing a security agreement with the cable operator, lender's counsel must review the ordinance carefully to ascertain what steps are appropriate. Franchise ordinances generally restrict assignability of the franchise and contain various obligations relating to the operation of the system. There is usually a procedure for termination of the franchise in the event of inadequate service or upon other contingencies. The franchise ordinance may also require that the laying of cable be accomplished according to a certain schedule,¹⁸ and may be granted either on an exclusive or non-exclusive basis.

The first obstacle to be surmounted by lender's counsel is generally the prohibition commonly found in franchise ordinances against assignment or hypothecation of the franchise. Whether or not such a restriction exists, it is generally advisable for the lender to gain the franchising municipality's express approval of the loan and the grant of a security interest in the franchise as collateral. This approval is important because of the broad discretionary control that the franchising municipality will have over the cable system and the resulting necessity of maintaining the goodwill of the municipality.¹⁹

The written consent of the municipality to the lender's loan and security interest is really only the first step in the process of creating an enforceable security interest. It is also advisable for the lender to obtain the express right, upon foreclosure, to transfer the system to a buyer of its choice. Ideally, this would be accomplished by a consent in advance by the municipality for the system to be sold to anyone whom the lender finds acceptable. However, most municipalities seek, for various political, social and economic reasons, to exercise close ongoing control over the entities that operate cable television systems. It is therefore likely that some compromise will need to be worked out that protects the lender's right to convey the cable system to a buyer in the event of foreclosure, but takes into account the municipality's desire to exercise control over the choice of a cable operator. Among the alternatives that may be employed are a provision that the municipality will agree to the sale of the system by the lender to any cable television operator that meets certain objective requirements (such as financial capability), a provision that such consent will not be

18. Evanow, *Construction*, CABLEVISION August 23, 1982, at 97.

19. See generally Kinley, *Franchising*, in CURRENT DEVELOPMENTS IN CATV 1981.

unreasonably withheld, or a provision that if the municipality does refuse to approve an otherwise competent bidder, the municipality will purchase the system itself for at least the amount of the outstanding balance of the loan. Obviously, the precise form of the municipality's advance consent to conveyance by the lender will be determined by the dynamics and relative bargaining strength of the parties. The more specific and less discretionary such a consent, the better the lender's position in case of default. In any event, the lender should, at the very least, insist that the municipality consent in advance to the transfer of control of the system upon foreclosure under some reasonable formula.

Another problem threatening the lender's security interest in the franchise is the possibility of premature termination of the franchise. As noted above, most franchise agreements have a provision for termination for inadequate service, and many have provisions that allow termination if the laying of cable falls seriously behind schedule or the municipality should decide to take over and operate the system itself. In this regard, it should be noted that doing business with a reliable cable operator is the best protection against the exercise of such provisions. As long as the customers of a system are satisfied with their service, it is unlikely that a franchise will be terminated. However, despite the best efforts of the cable operator, unanticipated technological or political problems may nevertheless bring into play such a termination provision. The result could be that, with the loss of the franchise, the original cable television system operator would own the tangible equipment and the new franchisee or the municipality would own the exclusive right to operate that system. In this kind of forced-sale situation, it is entirely conceivable that the original cable system operator would be obligated to sell its equipment to the new franchisee or the municipality for less than the amount of the outstanding loan. One solution is to require the municipality to agree in advance that upon any exercise of the termination or revocation provision, the lender will not be prejudiced.

An analogous problem is the matter of expiration and possible non-renewal of a franchise (franchises generally run from five to fifteen years).²⁰ At a minimum, lender's counsel should

20. Klein & Fleming, *Lending to the Cable Television Industry*, 64 J. COM. BANK LENDING 27, 30 (1982).

determine if the agreed-upon repayment schedule extends beyond the term of the current franchise. If so, it will be a business judgment on the part of the lender as to whether it is willing to assume the risk of nonrenewal. In any event, loss of the franchise—for whatever reason—should be specified as an event of default under the loan agreement.

Generally speaking, local governments have shown great creativity in drafting provisions in franchising ordinances that can and do severely restrict the transferability and value of franchises and therefore their value to lenders. Lender's counsel's strategy in dealing with all such provisions should be the same. First, there is no substitute for a careful review by lender's counsel of all laws and ordinances affecting the cable system. Second, lender's counsel should seek to have any problematic clauses waived by the municipality in full, or to the extent that they might prejudice the lender. Finally, if such provisions are not waived, counsel should fully explain to the client the extent to which these provisions can upset the economic assumptions on which the credit decision has been made. For example, many municipal ordinances contain a provision that requires the cable system, at the option of the municipality, to be sold to the municipality at a price that takes into account the tangible but not the intangible assets (a below-market price).²¹ Arguably, such a provision is unconstitutional, as a taking without just compensation.²² However, the lender is not interested in a legal battle on this point. Therefore, the lender's counsel should insist that such a provision either be waived entirely, or that the municipality agree to waive it to the extent necessary to satisfy any outstanding loans to the lender. The cable system and the municipality can then settle between themselves any remaining disputes as to additional compensation.

2. *Additional Agreements and Consents*

As noted above, the right to string cable on telephone poles or to lay it underground is a necessary element in operating a cable system.²³ For this reason, lender's counsel should make sure that the security agreement refers to all agreements and

21. *See, e.g.*, RIVERSIDE, CAL., MUNICIPAL CODE, § 5.56.260 (1970).

22. U.S. CONST. article 5; *Kimball Laundry Co. v. United States*, 338 U.S. 1, 12 (1949).

23. *See supra* note 6 and accompanying text.

consents relating to this right. Such agreements are often referred to as pole attachment agreements and public utility contracts. Lender's counsel should also seek to obtain from each party to such agreements and contracts consent to the lender's security interest and the agreement to recognize the lender or its assignee in the event of default or foreclosure. This process will generally be controlled by the laws affecting utilities in a given jurisdiction, subject to regulation by the FCC under certain circumstances.²⁴ Rights and agreements to wire particular buildings should also be properly covered.

Because each contract with each individual subscriber does not generally involve large sums, lender's counsel generally will not require any special documentation with respect to it. However, lender's counsel should briefly review the form of subscriber contract to assure that it complies with appropriate consumer and other laws, and with the terms of the franchise. Occasionally, the lender may wish to require remittances from subscribers to be sent to a post office box over which the lender has exclusive control.

In cases in which the lender has obtained a leasehold deed of trust or mortgage on the cable operator's leasehold interest in the head-end property, the lender should also obtain a standard estoppel letter from the lessor (consenting to the granting of the leasehold deed of trust and confirming the terms of the lease, the absence of default, etc.). In addition, the lender should obtain an attornment agreement²⁵ (agreeing to recognize the lessee's and lender's position upon succession to the lessor's interest) from any mortgagee or other party with an interest in the underlying fee which, if foreclosed upon, could wipe out the lessee's (and hence the lender's) interest.

III

Legal and Regulatory Impediments to the Realization of Anticipated Cash Flow

Although the decision to extend a particular credit to a particular cable system operator is a matter of business judgment, it is generally based on certain economic assumptions about

24. Christensen, *Pole Attachments*, in CURRENT DEVELOPMENTS IN CATV 1981 65 (1981).

25. An attornment agreement recognizes the lessee's and lender's position upon succession to the lessor's interest.

the operation and profitability of the cable system. These economic assumptions, in turn, may be significantly affected by legal developments. Lender's counsel must understand these economic assumptions and any legal problems that may undermine these assumptions, so that he can inform his client accordingly. This is particularly important in the area of cable television, in which the outline and scope of federal, state and local control is still being developed, and is changing almost on a daily basis.²⁶

A. Rate Controls

One of the crucial ingredients in the valuation of a cable system and, ultimately, the credit decision is the value per subscriber. The value per subscriber is based in part upon anticipated rates charged to subscribers.²⁷ Thus, any controls on such rates could dramatically alter this calculation. Counsel should therefore be aware of any sources of regulatory risk, such as federal, state or local legislation directly or indirectly affecting rates that may be charged by the cable system.²⁸ Current governmental policy on this point is in a state of flux.²⁹

B. Legal Developments Affecting Lender's Economic Assumptions About Competitive Threats to a Cable System

Many credit decisions are made on the economic assumption that the cable system operator requesting a loan will be the sole provider of enhanced television programming and related services in a particular geographic area. Recent legal and policy developments, however, have rendered such an assumption questionable. First, a recent United States Supreme Court decision opens up the possibility that despite the grant of an exclusive franchise, an existing cable system may have to compete with another cable system in a franchised area.³⁰ Second, the trend in recent regulatory and case law developments

26. Simon, *The Collapse of Consensus: Effects of the Deregulation of Cable Television*, 81 COLUM. L. REV. 612, 622-25 (1981).

27. Klein & Fleming, *Lending to the Cable Television Industry*, 64 J. COM. BANK LENDING 27, 29 (1982).

28. See, e.g., CAL. GOV'T CODE § 53066.1 (West 1982) (limited rate deregulation under certain conditions).

29. Leddy, *Lobbying War*, CABLEVISION, August 16, 1982, at 59.

30. *Community Communications, Inc. v. City of Boulder*, — U.S. —, 102 S. Ct. 835 (1982).

suggests that various legal restrictions on alternative technologies that compete with cable are being swept away.

The Supreme Court in *Community Communications Inc. v. City of Boulder, (Boulder)*³¹ held that municipal franchising and other cable-related activities are subject to the federal antitrust laws. The application of antitrust laws, as a result of *Boulder*, may affect the economic assumptions on which a cable loan is made. The most important economic assumption that the *Boulder* decision may affect is the exclusivity of a cable franchise. *Boulder* suggests that a cable system operator who has been granted an express or *de facto* exclusive franchise may not in fact enjoy an exclusive franchise. For example, a defeated applicant for the franchise may obtain an injunction which would have the effect of allowing the defeated applicant to race with the franchisee to place cable in the so-called exclusive territory. The economic assumption of exclusivity underlying the loan could therefore be upset.³² As a

31. *Id.*

32. It may well be that a lender will require a closer analysis of the probabilities that a particular franchise, or at least its exclusivity, will be overturned on antitrust grounds. Although precise analysis is impossible because of the lack of current direction from the courts and the unsettled legislative picture, the application of general antitrust principles suggest certain danger signals which, if present, would indicate that a franchise is particularly prone to antitrust attack.

1. *Procedure*

Was there a full and fair process for granting a franchise, in which all competitors had a fair opportunity to be heard and make their case? Did the municipality establish standards in advance for granting the franchise, and justify its decision according to those standards? The fairer the process, the less likely it is that a challenge will be successful.

2. *Necessity for Exclusivity*

The natural monopoly situation of most cable systems, and the inconvenience to the public of laying cable in the same area twice, provides substantial justification for exclusive franchises. *But see* National Society of Professional Engineers v. United States, 435 U.S. 679 (1978). However, in some situations, a dual system is in fact practical for various technical and topographical reasons. If a defeated applicant can present a legitimate practical argument as to how two systems can be placed in the same area, this will cause problems for any exclusive franchise.

3. *Length of Exclusive Right*

Even if an exclusive franchise is allowed, the length may be subject to question. Certainly, any franchise longer than fifteen years (the recommended FCC maximum) is subject to challenge as being unreasonably long. *See* Tampa Electric Co. v. Nashville Coal Co., 365 U.S. 320 (1961).

4. *Necessity for Wiring Expeditiously*

Does the franchise, or the plans of the cable system, call for wiring the exclusive area quickly? The longer the period of time in which an area covered by an exclusive grant is not wired, the stronger the argument of a competitor that he should not be excluded from the right to wire the area first.

practical matter, absent new federal legislation, there is no way a lender can be assured that a cable operator will in fact have an exclusive right. This uncertainty may simply have to be a risk which must be discounted in the lending process.

Other aspects of the franchise agreement, such as the length of the franchise and its territorial extent, may also be challenged on antitrust grounds. One approach to these problems is for the lender to seek an indemnity from the municipality with respect to any loss of exclusivity of the franchise or other antitrust problems. However, even if a municipality were to grant such an indemnity, the indemnity might well be invalid because of antitrust policy grounds or because of the municipality's lack of power to enter into such an agreement.

Recent antitrust developments suggest the possibility of competition from additional cable systems.³³ But perhaps even more significant to the lender's economic analysis is the competition to a cable system from the alternative technological systems that deliver an array of enhanced programming and other services without the use of cable. The alternative systems include a bewildering variety of new technologies such as subscription (scrambled broadcast signal) television, direct broadcast satellite, multipoint distribution service, satellite master antenna television (private cable), low power television and home viewing networks.³⁴ As each of these systems has become technologically feasible, the only barriers remaining have been regulatory and legal, and these barriers have tended to fall as a result of the current deregulatory emphasis. Lender's counsel should be prepared to advise the client concerning legal developments affecting and perhaps determining the viability of specific technologies that may provide a particular competitive threat to the cable system that is being financed. Perhaps the only safe generalization that can be made in this rapidly changing environment is that, as a legal and regulatory matter, no cable system can effectively be assured the exclusive right to provide enhanced television and related services to the area it covers.

33. See *supra* notes 30, 31, 32 and accompanying text.

34. Wiley, *The FCC Moves to Diversify Video Options in the Market Place*, National Law Journal, August 9, 1982, p. 54, col. 1. See also *supra* note 2.

IV Conclusion

National policy concerning legal and governmental control of cable is in a state of flux.³⁵ Equally unsettled are the multiplying technologies that compete with, complement and enhance cable television. In this uncertain environment, the advice of lender's counsel, both with regard to appropriate documentation and with regard to legal factors affecting the lender's credit decision, can be important in evaluating and protecting a long term loan for the development of a cable television system.

35. Simon, *The Collapse of Consensus: Effects of the Deregulation of Cable Television*, 81 COLUM. L. REV. 612, 622-25 (1981).

