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Financing a Communications Satellite Venture: Assessing Regulatory Risk is Key

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Communications satellite ventures are receiving much attention from the financial community these days and are being capitalized at a pace and in amounts never seen before. Investment bankers, underwriters, and lenders are embracing satellite communications projects ranging from small entrepreneurial single-satellite ventures to large multi-billion dollar communications satellite constellations, eager to secure financing through private placements, public offerings, and debt. Evidence of the enthusiasm in the public markets for satellite communications ventures is shown by the initial public offerings of Globalstar and Iridium in 1995 and 1997, which raised hundreds of millions of dollars.

Regulatory Risk

Despite the allure of vast unsaturated markets for satellite communications capacity, large revenues, and great returns on investment, there is significant risk associated with investing in communications satellite projects. There are financial risks, including funding uncertainties; technical risks, including the possibility of launch and satellite failures; market risk, including questions of product acceptance; and regulatory risk. Regulatory risk refers to the risk that the requisite governmental permits and approvals may not be obtained or obtained in a timely manner, and that laws, regulations, or policies may impede or delay project implementation. This type of risk requires particular care.

As a prospective investor in, or lender to, a communications satellite venture, it is essential that your institution, whether in Europe or in the US, be familiar with the applicable licensing and regulatory requirements and be able to answer questions like these: What authorizations, licenses, permits, and approvals are needed to implement the project? What is the time frame for obtaining these permits? What is the process involved? Is the outcome likely to be successful? What permits have been obtained? What conditions are attached? Are there overriding policy issues that might impede or slow the project? Is Congressional legislation required? Knowing the

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answers to these questions is key since without the requisite permits, the project may fail. This article highlights some of the regulatory issues that need to be addressed by prospective investors and lenders.

FCC License

In order to operate a communications satellite system or provide communications satellite services in the US, a license is required from the Federal Communications Commission ("FCC") pursuant to the Communications Act of 1934. The Act empowers the FCC to license and regulate "radio stations" and the FCC determined in 1970 that a satellite is a radio station and therefore within its jurisdiction. Since then, the FCC has taken charge of licensing and regulating all privately-owned US communications satellites and has developed an elaborate set of regulations, rules, and policies to guide this effort.

A license from the FCC to operate a satellite comprises a frequency assignment and also, in the case of geostationary satellites, an orbital location assignment. (The FCC does not assign altitudes to non-geostationary satellite constellations the way it does locations in the geostationary orbit; instead it endorses the altitude proposed by the applicant.) The FCC reserves the right to request the satellite operator to move the satellite to a different orbital location, a right the FCC has exercised on occasion. The license only allows for a temporary right to use frequency and orbit resources. Restrictions apply to the transfer of a license, the primary objective here being to prevent trafficking in licenses.

The FCC maintains an "open entry" policy for communications satellite systems, which means the FCC will license as many qualified satellite operators as can be accommodated within the available spectrum. Spectrum availability is a severe constraint, however. Although the FCC continues to open up new spectrum for satellite communications, the demand appears to exceed supply. To promote efficiency and fairness in the licensing proceedings, the FCC processes satellite applications in groups. A group is established by announcing a "cut-off date," within which all applicants wishing to be considered concurrently must file.

To obtain a license from the FCC, the applicant must show that: 1) the proposed service is in the "public interest," an anachronistic standard that is interpreted by the FCC to require, among other considerations, that the service benefit the public, e.g., by providing cheaper, more accessible, or better quality transmission; and 2) the applicant meets the FCC's requirements for technical, legal, and financial qualifications. Of these criteria, the financial qualification requirement has been the most controversial and is of particular interest to investors in, or lenders to, entrepreneurial ventures.

The FCC traditionally has imposed a strict financial qualification requirement in situations where there is insufficient spectrum to license all of the applicants in a processing group, i.e., where there is "mutual exclusivity." This usually means that the applicant must show, at the time the application is filed, current ability to finance the construction, launch, and one-year operation of the proposed satellite system. The FCC's rationale for imposing this tough standard is that forcing applicants to show that they have the funds to build and launch their systems prevents warehousing of valuable frequencies and orbital resources.

The strict financial qualification requirement has been severely criticized as being biased against small companies and favoring large, established ones, partly due to the FCC's double standard in implementing the requirement. Large companies can satisfy the requirement simply by showing that their balance sheet is sufficient to finance the proposed system; a corporate commitment to use the assets for that purpose is not necessary. Small entrepreneurial companies, on the other hand, which cannot produce the requisite balance sheet and therefore rely entirely on external sources, must show irrevocable commitments of financing sufficient for the construction, launch, and operation of the proposed satellite system, a test nearly impossible to meet at such an early stage of a venture.

Recent experience with large, billion dollar communications satellite constellations may cause the FCC to rethink the appropriateness of financial standards. These companies, while relying on their balance sheets to demonstrate financial qualifications, are nearly as dependent on external sources for funding as the small companies. For example, the "Big LEO" licensees, Motorola, Loral/Qualcomm, and TRW, all sought to attract world-wide financing for their respective constellations (Iridium, Globalstar, and Odyssey), although these companies committed considerable corporate financial resources. TRW ultimately turned in its license, apparently when it failed to attract sufficient outside investment.

Note that before imposing financial standards, the FCC generally appeals to the applicants themselves to resolve conflicting demands for frequencies and orbital locations ("slots") and to reach a settlement. While this approach did not yield results in the Big LEO proceeding, it did work, for example, in the first-round Ka-band licensing proceeding. Thirteen applicants for Ka-band slots were able to reach an agreement whereby all geostationary applicants were accommodated and subsequently licensed in May 1997. Applicants in the first-round V-band licensing proceeding, which submitted applications on September 26, 1997, will be encouraged to reach a similar agreement. The V-band is the new frontier in frequency spectrum recently opened up by the FCC for commercial satellite use.

ITU Coordination

In order to protect the FCC satellite frequency and orbital assignments internationally, coordination through the International Telecommunications Union ("ITU") is necessary. This coordination is handled formally by the FCC since only government agencies can interact with the ITU for this purpose. But in reality, the companies applying for satellite licenses must be prepared to do the work involved in preparing the technical filings the FCC submits to the ITU. Successful ITU coordination leads to registration in the ITU Master International Frequency Register and affords the registrant protection from frequency interference by subsequent systems.

Typically, the FCC begins the coordination process before it issues a license. Because ITU frequency protection is provided on a "first-come, first served" basis, and given the high demand for frequencies, the FCC is prepared to begin the process early to defend the interests of US companies. For example, the FCC initiated the ITU process for V-band applicants in November 1997, with AP-4 filings, and followed up six months later with APS-4 filings, although the agency had not granted any licenses yet in that band. Early initiation with the ITU helps US companies gain date priority, and thus frequency protection, over foreign entities.

Prior to investing in a satellite venture, it is key to determine whether the satellite operator has access to an uncontested orbital slot. In other words, does the entity have a registered slot and, if so, are there any conflicting claims to that slot? Conflicts arise when another entity claims the right to use either the same orbital slot, or a nearby slot in such a way that radio interference will result. Generally, slots in the same frequency band need to be two degrees apart in order to avoid interference.

Landing Rights and Access to Foreign Markets

To "land" a signal in a foreign country and provide satellite service to customers in foreign markets, a US company must obtain prior permission from the applicable foreign governments. Obtaining such permissions is a major challenge facing implementors of global satellite systems, such as Iridium and Globalstar. PanAmSat pioneered the pursuit of foreign landing rights in the 1980s when it began implementing its international satellite system. Recent agreements concluded under the auspices of the World Trade Organization ("WTO") have facilitated the task of gaining access to foreign markets. In November 1997, the FCC adopted the so-called "DISCO II" Order, which regulates access by foreign companies to US markets. ICO and Kitcomm are among the companies currently seeking access under the DISCO II Order.

Trade Agreements and Export License

In cases where a US-made commercial communications satellite is to be launched on a foreign launch vehicle from foreign territory, an export license is required from the Department of Commerce and, in certain instances, also from the Department of State. In addition, if the launch provider is Chinese, Russian, or Ukrainian (including joint ventures with partners from these countries), compliance with bilateral launch trade agreements must be ensured. These agreements restrict the quantity of launches and impose restrictions to prevent unfair pricing by launch providers from these countries.

Conclusion

This note has touched upon some of the approvals needed to implement a communications satellite venture, and there are others. Before investing in or lending to a communications satellite venture, and in analyzing the venture's business plan, it is critical to determine whether all of the regulatory requirements have been properly identified and accounted for; whether sufficient time and resources have been allocated to meet the requirements; and whether a sound strategy is in place for securing the requisite permits.