Some Added Security: Applying Lessons from Bankruptcy Law to Strengthen the Collection of Consumer Fraud Penalties

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I. INTRODUCTION

A government agency's ability to collect fines is a telling indicator of whether an agency is more bark than bite. If an agency cannot practically collect its fines, its constituency takes notice. A constituent's cost of punishment suddenly becomes a predictable metric that can be strategically mitigated, and the agency loses its leverage as a regulator and enforcer over time, while the constituency's maligned behaviors persist. One need only look to the current state of the telecommunications industry to see a potential microcosm of this dynamic.

The Federal Communications Commission ("FCC") infamously struggles to practically collect the civil penalties it imposes on its constituents for consumer fraud.[1] Despite enforcement assistance from the Federal Trade Commission ("FTC"),[2] the FCC's shortcomings have conditioned a telecommunications industry that no longer blinks at the announcement of enormous consumer fraud penalties.[3] Sensational headlines often trumpet massive fines against the industry's largest corporations, but they do not capture reality.[4] In truth, these penalties might go uncollected for several years.[5] As a former Director of Research at the Consumer Federation of America once lamented: "When the lion roars, the gazelles run. The problem is that if the lion roars too much and never eats a meal, the gazelles will stop running."[6]

Indeed, the gazelles of the telecommunications industry have stopped running, but there is greater cause for concern on the horizon. An unresolved disagreement amongst federal courts over a particular section of the United States Bankruptcy Code ("the Code") might offer telecommunications companies a way to completely erase their consumer fraud penalties through Chapter 11 reorganization, further upsetting the FCC and FTC's practical ability to collect their fines.[7] While the United States' bankruptcy system is not intended as a means for corporate debtors to escape accountability for consumer fraud, a general understanding of the corporate bankruptcy process reveals how such an opportunity can arise.

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1. *See* Alex Byers, *FCC Proposes Millions in Fines, Collects $0*, POLITICO (Nov. 23, 2015, 6:01 PM), https://www.politico.com/story/2015/11/fcc-fine-enforcement-scrutiny-216121 [https://perma.cc/L9PV-DQUE].

2. *See* Press Release, Fed. Trade Comm'n, FTC Enforcement Actions Continue to Target "Crammers" (July 16, 1998), https://www.ftc.gov/news-events/press-releases/1998/07/ftc-enforcement-actions-continue-target-crammers [https://perma.cc/QP6X-QNZW].

3. *See* Byers, *supra* note 1.

4. *See, e.g.*, Diane Bartz & Alina Selyukh, *AT&T to Pay $105 Million to Settle Charges It 'Crammed' Phone Bills*, REUTERS (Oct. 8, 2014, 11:52 AM), https://www.reuters.com/article/us-at-t-cramming-settlement/att-to-pay-105-million-to-settle-charges-it-crammed-phone-bills-idINKCN0HX1QP20141008 [https://perma.cc/R528-CMKA].

5. *See* Byers, *supra* note 1.

6. *Id.*

7. *See* Douglas Mentes, *Reorganized Telecom Company Wipes Out $2 Million FCC Penalty*, 17 No. 6 WESTLAW J. BANKR. 1 (2020).

When a distressed corporation files for relief under Chapter 11 of the Code, the corporation becomes a federally protected debtor.[8] In turn, the government can no longer collect its penalty claims against the debtor corporation.[9] This gives the corporation time to implement a plan of reorganization that restructures its capital arrangements and permits it to exit as a solvent entity.[10] Any creditor whose claim against the corporation is not backed by collateral is classified as an unsecured creditor[11] and ranks low within the creditor hierarchy without any guarantee of recovery.[12] Consumer fraud penalties levied by the FCC and FTC fall under unsecured status.[13] If the debtor corporation seeks to discharge the penalty in its plan of reorganization, it may very well succeed in doing so, despite the fact that that debt was the consequence of fraud.[14] For the FCC and FTC, this is the worst case scenario.

A recent case in the United States Bankruptcy Court for the Southern District of New York brought this exact fear to light. In 2019, Fusion Connect, Inc., a telecommunications provider, filed for bankruptcy and nearly discharged a $2.1 million FCC consumer fraud penalty levied via consent decree.[15] The bankruptcy judge ruled that where the government itself is not an injured victim of the fraudulent scheme, the penalty is dischargeable.[16] But on appeal, the bankruptcy court's ruling was reversed,[17] rekindling an awareness within the federal judiciary of disagreement.[18] And it has significant potential side effects.

Practitioners fear that the *In re Fusion Connect* saga serves as a precursor to what will soon become common practice in the telecommunications industry.[19] Telecommunications companies may begin to test courts with bankruptcy spinoffs.[20] Here, they may offload their consumer fraud penalties into subsidiaries solely for the purpose of discharging them in bankruptcy.[21] And this will not only perpetuate the FCC and FTC's struggles to collect their penalties, but also the agencies' ability to curb mass market consumer fraud. To address these problems, this Note argues that by

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8. *See* 11 U.S.C. § 301.
9. 11 U.S.C. § 362.
10. *See* Ralph R. Mabey & Patrick S. Malone, *Chapter 11 Reorganization of Utility Companies*, 22 ENERGY L.J. 277, 282-83 (2001) (providing a background section on general concepts of Chapter 11 bankruptcy).
11. 11 U.S.C. § 506(a)(1).
12. 11 U.S.C. § 1129(b)(2).
13. 11 U.S.C. § 507(a)(8)(G).
14. *See In re* Fusion Connect, Inc., 617 B.R. 36, 44-45 (Bankr. S.D.N.Y. 2020), *rev'd*, 634 B.R. 22 (S.D.N.Y. 2021).
15. *Id.* at 39.
16. *Id.* at 44-45.
17. *In re* Fusion Connect, Inc., 634 B.R. 22, 24 (S.D.N.Y. 2021).
18. Michael L. Cook, *Appellate Court Holds FCC Penalty Claim Survives Chapter 11 Corporate Debtor's Discharge*, SCHULTE ROTH & ZABEL (Sept. 14, 2021), https://www.srz.com/resources/appellate-court-holds-fcc-penalty-claim-survives-chapter-11.html [https://perma.cc/7ZCW-KD3L].
19. *See id.*
20. *See id.*
21. *In re Fusion Connect, Inc.*, 634 B.R. at 38.

modifying the way the FCC and FTC issue their consumer fraud penalties, the agencies can not only protect their claims in bankruptcy but strengthen their overall ability to collect their fines and disincentivize default.

This Note first requires an in-depth background discussion. Section II.A.1 elucidates the relevant framework of Chapter 11 bankruptcy reorganization. Section II.A.2 details the relevant statutes governing the nondischargeability of certain debts. Section II.B then illuminates the *In re Fusion Connect* saga's near successful exploitation of Section 523(a)(2)(A) of the Code. From here, Section II.C.1 explores why the FCC and FTC should heed the warnings identified in *In re Fusion Connect*, namely bankruptcy spinoffs and liability offloading. Section II.C.2 then concludes the background with an examination of consumer fraud in the telecommunications industry.

This Note then proposes a solution that focuses solely on those FCC and FTC penalties levied via consent decrees, as seen in *In re Fusion Connect*. Section III.A explains that the best resolution requires two modifications to the way these agencies draft their agreements. Section III.B suggests that consent decrees should first reduce offloading concerns by stipulating that their penalties cannot be assigned to subsidiaries, independent spinoffs, and other third parties. Section III.C then proposes that consent decrees should attach the corporations' FCC licenses to the penalties to create security interests that characterize the government as a secured creditor. Such a plan offers an effective means at addressing the issues rediscovered by the *In re Fusion Connect* saga and presents a sustainable solution grounded in undisputed bankruptcy law.

II. BACKGROUND

A. The General Framework of Corporate Bankruptcy Law

1. The Mechanics of Chapter 11 Reorganization

Bankruptcy is a unique legal process codified under federal law that permits entities distressed by crippling debts the opportunity to seek relief from their obligations to creditors.[22] It is one of the few contexts where judicial intervention is not punitive, but rather seeks to secure a better outcome than would otherwise be received by all parties without the court's assistance.[23] This is especially the case in "reorganization" bankruptcies, such as those filed under Chapter 11 of the Code.[24] In many ways, a reorganization arguably transforms the court's role into that of a broker, always concerned about striking the deal. Reorganization bankruptcy involves a highly sophisticated framework of procedure, litigation, negotiated transactions, and business decisions. It employs its own terms of the trade to make sense of it all. Accordingly, this Note narrowly examines only a few points within that

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22. *See* Mabey & Malone, *supra* note 10, at 277-79.
23. *See id.* at 282.
24. *See id.* at 278.

complex framework and walks through a typical Chapter 11 bankruptcy reorganization from beginning to end.

A bankruptcy proceeding under Chapter 11 of the Code commences with the filing of a Chapter 11 petition in a federal bankruptcy court.[25] A bankruptcy court is a unit of the federal judiciary and is endowed with subject matter jurisdiction over most bankruptcy case matters under Article I of the United States Constitution.[26] Therefore, all bankruptcy law is federal law and subject to the review of federal appellate courts.[27] Bankruptcy appeals, however, have a unique process that, depending on the jurisdiction, may escalate via different paths.[28] For instance, decisions and orders issued by certain bankruptcy courts are generally appealed directly to their corresponding federal district courts.[29] As such, a decision by the United States Bankruptcy Court for the Southern District of New York is generally appealed to the United States District Court for the Southern District of New York.[30] However, the First, Sixth, Eighth, Ninth, and Tenth Circuits employ Bankruptcy Appellate Panels ("BAPs") to review bankruptcy court decisions.[31] Such panels are authorized under 28 U.S.C. § 158(b) and consist typically of three bankruptcy judges appointed by their respective circuit courts.[32] Bankruptcy appeals reviewed by the district court or BAPs may then be appealed up to the circuit courts and then to the United States Supreme Court, following the traditional path of federal appellate review.[33]

A Chapter 11 bankruptcy petition contains itemized schedules of the distressed corporation's financial affairs.[34] This includes itemized schedules of the corporation's assets and liabilities.[35] Assets include tangible assets, as well as ownership interests, revenue contracts, and other non-trivial property that falls under the bankruptcy estate pursuant to 11 U.S.C. § 541.[36] Liabilities include any claims to money owed by the corporation to its creditors, which may be loans, bond payments, contractual obligations, lawsuit judgments, or government civil penalties.[37] This is where the relevant creditors to the bankruptcy petition become apparent, establishing a picture of the corporation's overall capital structure.[38] Here, the assets usable for the generation of funds toward the reorganization are set against the corporation's

25. 11 U.S.C. § 301.

26. U.S. CONST. art. I, § 8, cl. 4; 28 U.S.C. § 151.

27. U.S. CONST. art. I, § 8, cl. 4; *see* 28 U.S.C. § 158(d).

28. *See generally* 28 U.S.C. § 158.

29. 28 U.S.C. § 158(a).

30. *See, e.g.*, *In re* Fusion Connect, Inc., 617 B.R. 36, 40 (Bankr. S.D.N.Y. 2020), *rev'd*, 634 B.R. 22 (S.D.N.Y. 2021).

31. *Court Insider: What Is a Bankruptcy Appellate Panel?*, ADMIN. OFF. U.S. CTS. (Nov. 26, 2012), https://www.uscourts.gov/news/2012/11/26/court-insider-what-bankruptcy-appellate-panel [https://perma.cc/2Z8E-SMNV].

32. 28 U.S.C. § 158(b).

33. 28 U.S.C. § 158(d); FED. R. APP. P. 3, 4.

34. FED. R. BANKR. P. 1007(b)(1).

35. FED. R. BANKR. P. 1007(b)(1)(D).

36. 11 U.S.C. § 541.

37. *See* 11 U.S.C. § 101(5), (12).

38. *See generally* 11 U.S.C. § 521(a)(1)(A).

total debts.[39] Within that capital structure exists a "fulcrum," or the point at which value breaks.[40] In other words, creditors who sit above the fulcrum stand to recover the full value of their claims against the corporation.[41] Those who sit below the fulcrum are at risk of only receiving partial recovery or stand to receive no recovery at all.[42]

The bankruptcy petition separately identifies a list of creditors according to their position within the hierarchy governed by what is called the "absolute priority rule."[43] The absolute priority rule states that a subordinate claim may not be paid recovery until all relative superior claims are paid their recovery in full.[44] Generally speaking, debt is senior to equity.[45] Therefore, creditors are superior to shareholders.[46] The creditor class is separately striated into several categories within the hierarchy.[47] It is most important to distinguish between secured and unsecured creditors. A secured creditor holds a claim against the corporation that has some form of collateral attached to it as security.[48] An unsecured creditor holds a claim against the corporation that does not have any attached collateral.[49] A secured creditor is superior to an unsecured creditor under the absolute priority rule.[50] Generally, unsecured creditors are at higher risk of receiving partial or no recovery of their claims in the bankruptcy reorganization.[51] A secured creditor with a large claim will generally be made whole and may have a lot of influence in the bankruptcy's trajectory.[52]

One of the most important mechanisms of Chapter 11 bankruptcy is the automatic stay. Upon the bankruptcy petition's filing, regardless of its sufficiency or completeness, an automatic stay immediately goes into effect pursuant to 11 U.S.C. § 362.[53] The automatic stay temporarily prevents any creditor, collection agency, or government agency from collecting or pursuing any pre-petition claims against the corporation.[54] The Code makes an exception for certain government actions under 11 U.S.C. § 362(b)(4), stating that the automatic stay does not apply to "the commencement or continuation

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39. *See* 11 U.S.C. § 521(a)(1)(B)(i); *see also Chapter 11 – Bankruptcy Basics*, ADMIN. OFF. U.S. CTS., https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics [https://perma.cc/4U6L-AC7K] (last visited Sept. 18, 2022).

40. *See* Nicholas Ortiz, *What Is a Fulcrum Security in Bankruptcy?*, BANKR. L. NETWORK (Dec. 23, 2011, 12:04 PM), https://bankruptcylawnetwork.com/what-is-a-fulcrum-security-in-bankruptcy/ [https://perma.cc/D8ZE-ELPA].

41. *See id.*

42. *See id.*

43. *See* 11 U.S.C. §§ 521(a)(1)(A), 1129(b)(2).

44. *See* 11 U.S.C. § 1129(b)(2).

45. *Id.*

46. *See id.*

47. *See id.*

48. *See* 11 U.S.C. § 506(a)(1).

49. *See id.*

50. 11 U.S.C. § 1129(b)(2).

51. *See* Ortiz, *supra* note 40.

52. *See id.*

53. *See* 11 U.S.C. § 362.

54. *See id.*

of an action or proceeding by a governmental unit . . . to enforce such governmental unit's . . . police and regulatory power, including the enforcement of a judgment other than a money judgment, obtained in an action or proceeding by the governmental unit to enforce such governmental unit's . . . police or regulatory power."[55] This carve-out is important because it contains an exception to an exception. By excepting government actions other than money judgment collections, the Code effectively stays the collection of government penalties.[56] All claims falling under the freeze of the automatic stay therefore remain frozen until their fates are determined by a subsequent confirmed plan of reorganization.[57]

The debtor corporation ultimately seeks to confirm a plan of reorganization that restructures the terms of the corporation's outstanding obligations.[58] The corporation, known officially upon the petition's filing as a Debtor-In-Possession,[59] has 120 days from the petition date to exclusively propose its own plan of reorganization.[60] During this time, not even the creditors can propose their own plans.[61] Pursuant to 11 U.S.C. § 1123(a)-(b), all proposed plans must provide for the treatment of every identified claim holder.[62] The debtor corporation additionally has 180 days from the petition date to obtain acceptances to its proposed plan.[63] After these periods lapse, any creditor may propose its own plan for acceptance.[64] Acceptances are submitted by vote according to class of claim.[65] Claim classes are generally categorized as impaired and unimpaired.[66] Claims belonging to the unimpaired class sit above the fulcrum, while claims belonging to the impaired classes sit at or below the fulcrum.[67] Claims belonging to the unimpaired class are automatically considered accepting of the plan.[68] Votes therefore need only be solicited from creditors holding claims under the impaired classes.[69] The proposed plan wins acceptance from an impaired class if it receives acceptance votes from creditors holding at least two-thirds of the overall debt within that class and if those votes constitute a majority of the total creditors within that class.[70] So long as the proposed plan receives acceptance from at least one class of impaired creditors, the plan may be confirmed by order of the bankruptcy court.[71]

55. 11 U.S.C. § 362(b)(4).
56. *See id.*
57. *See* 11 U.S.C. §§ 362(c)(1), 1327(b).
58. *See* Mabey & Malone, *supra* note 10.
59. 11 U.S.C. § 1107.
60. 11 U.S.C. § 1121(b).
61. *See id.*
62. 11 U.S.C. § 1123(a)-(b).
63. 11 U.S.C. § 1121(c)(3).
64. 11 U.S.C. § 1121(c).
65. 11 U.S.C. § 1126(c).
66. *See* 11 U.S.C. § 1126(f).
67. *See* Ortiz, *supra* note 40.
68. 11 U.S.C. § 1126(f).
69. *See id.*
70. 11 U.S.C. § 1126(c).
71. *See id.*

Upon confirmation of the corporation's plan of reorganization, the bankruptcy court orders a discharge of the corporation's pre-petition liabilities pursuant to the plan.[72] The discharge effectively cancels all impaired debts slated for zero recovery under the plan.[73] Thereon, the corporation is legally bound by the plan and must meet its restructured payments and contractual obligations as stipulated.[74] As discussed, depending on the terms of the plan, not all creditors will be made whole, especially creditors whose claims are not backed by collateral.[75] The voting structure governing the plan's confirmation provides for the approval of the plan, despite the existence of many dissenting creditors.[76] And because any given corporate reorganization may implicate millions or billions of dollars of debt and distressed assets across dozens of creditors and third parties, litigation inevitably arises to challenge a debt's dischargeability.

2. 11 U.S.C. § 523 Exceptions to Discharge

Section 523 of the Code codifies which claims cannot be discharged in bankruptcy.[77] Despite the tremendous care with which Congress aimed to draft this section, it is still steeped in controversy, especially in the context of claims implicating fraud. Often, the litigation invoking a Section 523 exception is more a dispute over the interpretation of the statute as opposed to the interpretation of the facts underlying the claim. A survey of this statute's framework reveals why.

Any plan of reorganization that calls for the discharge of a debt may be challenged by the creditor in a separate adversary proceeding.[78] In such circumstances, the plaintiff in the adversary proceeding is typically a creditor holding an impaired claim against the debtor corporation, and the debtor corporation is generally the defendant.[79] The plaintiff commences the adversary proceeding, like any other civil lawsuit,[80] and seeks relief in the form of a friendly treatment of its claim in the reorganization.[81] Adversary proceedings can address various contested matters arising under the bankruptcy from the validity of an interest to the subordination of a debt.[82] The adversary proceeding can also potentially foreclose further litigation of

72. *See* 11 U.S.C. § 1141(d)(1)(a).
73. *See* 11 U.S.C. § 1141(a), (c), (d)(1)(A).
74. 11 U.S.C. § 1141(a).
75. *See* Ortiz, *supra* note 40.
76. *See* 11 U.S.C. § 1126(c).
77. *See* 11 U.S.C. § 523.
78. *See* FED. R. BANKR. P. 7001.
79. *See, e.g.*, *In re* Fusion Connect, Inc., 617 B.R. 36, 40 (Bankr. S.D.N.Y. 2020), *rev'd*, 634 B.R. 22 (S.D.N.Y. 2021).
80. *See* FED. R. BANKR. P. 7003.
81. *See* FED. R. BANKR. P. 7001.
82. *See* FED. R. BANKR. P. 7001(2), (8).

the matter.[83] Therefore, if Creditor A proposes a plan that is hostile to Creditor B's claim against the debtor corporation, Creditor B can directly litigate against the debtor corporation to seek lasting protection and a final determination of its claim's fate.[84]

Creditors often argue for the protection of their claims by asserting that their claims are excepted from discharge.[85] The Code specifically enumerates nineteen different categories of claims that are not dischargeable under Section 523.[86] These categories range from debts arising from domestic support obligations and vehicular personal injury to federal securities law violations.[87] This Note principally examines the exception to discharge provided under Section 523(a)(2)(A) of the Code, which concerns debts arising from fraudulent activity.[88]

Section 523(a)(2)(A) of the Code bars the discharge of a debt "obtained by . . . false pretenses, a false representation, or actual fraud . . . ."[89] However, Section 523 statutory exceptions to discharge pertain only to "individual[s]" and do not reference corporate entities.[90] This distinction is important. Case law widely acknowledges that the term "individual" in the context of the Section 523 exceptions applies only to people who file for consumer bankruptcy protection.[91] Accordingly, Congress passed additional statutes designed to apply the Section 523 exceptions to corporate debtors and added Section 1141(d)(6)(A) to the Code in 2005.[92] This particular statute bars a "debtor that is a corporation" from a discharge of "any debt . . . of a kind specified in paragraph (2)(A) or (2)(B) of Section 523(a) that is owed to a domestic government unit . . . ."[93] However, what was thought to be strong and clear statutory language constructed to hold defrauding corporations accountable to government penalties and fines was actually found to be grossly underdeveloped.

Where the government filed an adversary proceeding on a Section 523(a)(2)(A) claim as the victim of the corporate debtor's fraud, the law and surrounding jurisprudence was well established, consistently finding the debt

83. *See, e.g.*, 10 COLLIER ON BANKRUPTCY ¶ 7001.07 (16th ed. 2022) ("If the debt . . . is held dischargeable by the court after trial, the creditor holding that debt is thereafter barred from suing on it in another court or seeking to enforce it through legal process. Should the creditor commence or continue a suit on the debt thereafter, any judgment obtained is rendered null and void."); *see also* FED. R. BANKR. P. 7001(6).

84. *See* FED. R. BANKR. P. 7001.

85. *See* 11 U.S.C. § 523.

86. *See* 11 U.S.C. § 523(a).

87. *See id.*

88. *See* 11 U.S.C. § 523(a)(2)(A).

89. *Id.*

90. 11 U.S.C. § 523(a).

91. 4 COLLIER ON BANKRUPTCY ¶ 523.04 (16th ed. 2022).

92. *See In re Fusion Connect, Inc.*, 617 B.R. at 40.

93. 11 U.S.C. § 1141(d)(6)(A).

nondischargeable.[94] But when the government was not the victim of the fraud, but was instead attempting to collect a penalty levied for the debtor's fraud against consumers or some other third party, the Code began to unravel and divide federal jurisprudence across circuit jurisdictions.[95]

B. *The* In re Fusion Connect *Saga*

The apparent underdevelopment of Section 523(a)(2)(A) of the Code has recently returned as a hot button subject in the bankruptcy practice. A recent Chapter 11 case in the United States Bankruptcy Court for the Southern District of New York strained bankruptcy jurisprudence on the statute. The case, *In re Fusion Connect*, rekindled an awareness of disagreement among federal courts on whether government consumer fraud penalties are dischargeable in bankruptcy pursuant to Section 523(a)(2)(A).[96]

In 2015, the Enforcement Bureau of the FCC launched an investigation into allegations of consumer fraud committed by Birch Communications Inc. ("Birch"), better known by the name of its successor, Fusion Connect Inc. ("Fusion").[97] The results of the FCC's investigation concluded that Birch had defrauded its customers, many of which were small businesses.[98] By 2016, Birch had entered into a consent decree by an order of the FCC and agreed to pay the United States an unsecured civil penalty of $4.2 million over five years.[99] For three years, Birch met its monthly obligations pursuant to the consent decree and by 2019 had paid nearly half of its civil penalty.[100] However, the FCC's blissfully passive enforcement of the consent decree would soon come to an end. Bound by the consent decree's assignment of liability, Fusion assumed responsibility for the outstanding penalty in 2018 when it merged with Birch's parent company.[101] And in June of 2019, Fusion voluntarily filed for Chapter 11 in the United States Bankruptcy Court for the Southern District of New York.[102]

Fusion's plan of reorganization called for the discharge of the $2.1 million FCC penalty left unpaid to the United States.[103] The Government commenced an adversary proceeding to challenge Fusion's proposed treatment of the penalty under the plan, claiming that the penalty was

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94. *See, e.g.*, Andrews v. Michigan Unemployment Ins. Agency, 891 F.3d 245, 249-50 (6th Cir. 2018) (citing Cohen v. de la Cruz, 523 U.S. 213 (1998)); *see also In re Fusion Connect, Inc.*, 617 B.R. at 41 ("[W]here a governmental unit is the victim of actual fraud, a non-compensatory penalty that forms part of the award is non-dischargeable under section 523(a)(2)(A) . . . .").

95. *See* Anupama Yerramalli et al., *Fines for Defrauding Consumers are Dischargeable*, AM. BANKR. INST. J., Sept. 2020, at 6, 6.

96. *See* Mentes, *supra* note 7, at 1.

97. *See In re* Fusion Connect, Inc., 617 B.R. 36, 38 (Bankr. S.D.N.Y. 2020), *rev'd*, 634 B.R. 22 (S.D.N.Y. 2021).

98. *Id.*

99. *Id.* at 38-39.

100. *Id.* at 39.

101. *Id.*

102. *Id.*

103. *In re Fusion Connect, Inc.*, 617 B.R. at 39.

nondischargeable pursuant to Section 523(a)(2)(A) of the Code[104] and that Birch's FCC consumer fraud penalty constituted a debt "obtained by . . . false pretenses, a false representation, or actual fraud . . . ."[105]

Judge Stuart Bernstein ruled that the unpaid FCC penalty was indeed dischargeable and reasoned that because the FCC itself was not an actual victim of Birch's fraud, Section 523(a)(2)(A) did not bar the penalty's discharge.[106] Judge Bernstein explained that the Code's conception of actual fraud "is tethered to the common law conception of fraud" and cannot substantiate a claim in "the absence of a misrepresentation to the FCC."[107] Citing two United States Supreme Court cases, *Cohen v. de la Cruz* and *Husky International Electronics, Inc. v. Ritz*, Judge Bernstein noted that in both cases, the plaintiffs were the actual defrauded victims and "neither decision extends the notion of common law fraud to someone who has not been defrauded and has not suffered a pecuniary loss."[108] Judge Bernstein additionally borrowed from an analogous 2020 decision from the Delaware Bankruptcy Court that was affirmed on appeal to the United States District Court of Delaware.[109] The case, *In re Exide Technologies*, held that government fines levied for the violation of environmental regulations could be discharged in a corporate reorganization plan.[110] While no fraud was alleged in that case, the Bankruptcy Court offered its thoughts on how it would have ruled.[111] The District Court of Delaware agreed with the Bankruptcy Court's reasoning, affirming that "[Section] 523(a)(2)(A) is not applicable . . . because the claim did not satisfy a prima facie element of fraud: 'that a *creditor* sustained loss and damages as a proximate result of the misrepresentations having been made.'"[112] Following *Cohen*, the Delaware District Court affirmed that this principle required a debt to be traceable to a fraud against the creditor itself.[113]

On appeal to the United States District Court for the Southern District of New York, Judge Bernstein's findings were reversed.[114] The District Court interpreted *Cohen* in a different manner.[115] It particularly emphasized the breadth of *Cohen*'s language in its holding that "[Section] 523(a)(2)(A) bars the discharge of all liability arising from fraud."[116] However, the Supreme Court had originally handed down this ruling to resolve the issue of whether Section 523(a)(2)(A) applied to treble damages imposed on top of actual

104. *Id.*
105. 11 U.S.C. § 523(a)(2)(A).
106. *In re Fusion Connect, Inc.*, 617 B.R. 36, at 44-45.
107. *Id.* at 44.
108. *Id.* at 45.
109. *Id.* at 42.
110. *Id.*
111. *Id.*
112. *In re* Exide Techs., 613 B.R. 79, 87 (D. Del. 2020) (quoting *In re* Exide Techs., 601 B.R. 271, 282 (Bankr. D. Del. 2019)) (emphasis added).
113. *Id.* at 88.
114. *In re* Fusion Connect, Inc., 634 B.R. 22, 24 (S.D.N.Y. 2021).
115. *Id.* at 30-31.
116. *Id.* at 31 (quoting Cohen v. de la Cruz, 523 U.S. 213, 222 (1998)).

damages for judgements arising from fraud.[117] In other words, the pertinent language of *Cohen* applies to claim calculations and does not necessarily inform what type of fraudulent conduct satisfies Section 523(a)(2)(A).[118] But according to the District Court's reasoning, the *Cohen* analysis extended Section 523(a)(2)(A) to cover the FCC penalty as a qualifying debt related to the original fraud, and consequently held "that the FCC Penalty fit[] within the § 523(a)(2)(A) exception to dischargeability."[119]

Despite this reversal, the *In re Fusion Connect* saga revived an awareness of the apparent disagreement surrounding the dischargeability of government penalties levied to punish fraud.[120] Fusion ultimately did not appeal the District Court's decision to the United States Court of Appeals for the Second Circuit. However, this case represents the SDNY Bankruptcy Court and District Court's first commentaries on the question. It is unknown whether Judge Bernstein's opinion is shared amongst any of the other judges under the Second Circuit judiciary. Regardless, the Second Circuit has yet to rule on the question, and there is an apparent disagreement between the Southern District of New York and Delaware over how far *Cohen* should stretch jurisprudence on 523(a)(2)(A) regarding the nondischargeability of government penalties for fraud.[121] Given that these districts are among the country's most influential bankruptcy courts, such a divide might prompt the Supreme Court to eventually address the issue with precision and put the ambiguity to rest.

C. Causes for Concern

1. Looming Concerns over Liability Offloading in Corporate Bankruptcy

One of the discernable concerns coming out of the *In re Fusion Connect* saga is the implications it might have on telecommunications providers' treatment of federal penalties. Where bankruptcy courts are particularly sympathetic towards corporate debtors facing large government penalties, strategic offloading becomes an attractive measure to evade punishment for consumer fraud.[122] The timing here is especially concerning because in October 2021, Johnson & Johnson initiated a controversial bankruptcy offload to distance itself from its talcum powder mass tort liability.[123] This has revived considerable concern and debate over the practice.[124]

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117. Cohen v. de la Cruz, 523 U.S. 213, 215 (1998).

118. *Id.* at 222.

119. *In re Fusion Connect, Inc.*, 634 B.R. at 32.

120. Cook, *supra* note 18.

121. *See id.*

122. *See In re* Fusion Connect, Inc., 634 B.R. 22, 38 (S.D.N.Y. 2021).

123. Mike Spector & Dan Levine, *J&J Puts Talc Liabilities into Bankruptcy*, REUTERS (Oct. 15, 2021, 11:50 AM), https://www.reuters.com/business/healthcare-pharmaceuticals/jj-unit-manage-talc-claims-files-bankruptcy-protection-2021-10-14/ [https://perma.cc/X3XP-7LGS].

124. *See id.*

Offloading is the term used to describe the scenario when a corporation creates a subsidiary whose purpose is to accept a transfer of liability and file for bankruptcy protection.[125] While this strategy was designed to shield larger, established corporate entities from failing due to liabilities accrued from unanticipated environmental disasters and product recalls, many criticize the strategy as giving corporations a way to escape accountability for their injurious activities, especially in the context of consumer fraud.[126] As Judge Paul A. Engelmayer noted in his decision reversing Judge Bernstein's ruling in *In re Fusion Connect*, "statutory construction permitting a company—or its assignee—to shed a regulatory fraud penalty in this manner could invite mischief . . . [and] incent the strategic offloading of such a liability onto a successor entity primed soon to file for reorganization under chapter 11."[127] He further added, "The risk of such mischief may be all the greater given that the company . . . had a recent history of fraud."[128] Accordingly, policy implications explicitly warn that telecommunications providers already predisposed to commit consumer fraud may also exploit the perverse incentives offered by liability offloading.[129]

In such scenarios, any corporation liable for millions of dollars in FCC or FTC consumer fraud penalties may create a subsidiary to take on the liability.[130] Once the subsidiary files for bankruptcy, the FCC's ability to collect the judgment is frozen due to the automatic stay.[131] After months or even years of delayed litigation, the debtor subsidiary may seek to confirm a plan that discharges the penalty. Even if not discharged, at best, the penalty's collection is delayed. But in all likelihood, the FCC and debtor subsidiary could enter negotiations on the matter and settle at a much lower amount, effectively undermining the government's ability to collect damages for the debtor's violation of federal law. Such a reality is unsustainable and should no longer be tolerated by the federal government, especially given how pervasive consumer fraud is within the telecommunications industry.[132]

2. Mass Market Consumer Fraud in the Telecommunications Industry

Another discernable concern arising from the *In re Fusion Connect* saga is that, given the potential for telecommunications companies to escape FCC and FTC consumer fraud penalties through reorganization or bankruptcy offloads, consumer fraud in the telecommunications industry will persist

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125. *Id.*

126. *See generally* DAVID F. LARCKER ET AL., STAN. CLOSER LOOK SERIES, ENVIRONMENTAL SPINOFFS: THE ATTEMPT TO DUMP LIABILITY THROUGH SPIN AND BANKRUPTCY (2020), https://www.gsb.stanford.edu/sites/default/files/publication-pdf/cgri-closer-look-87-environmental-spinoffs_0.pdf [https://perma.cc/2EXG-CN3H].

127. *In re Fusion Connect, Inc.*, 634 B.R. at 36.

128. *Id.* at 36-37.

129. *See id.*

130. *See id.*

131. *See* 11 U.S.C. § 362(b)(4).

132. *See* discussion *infra* Section II.C.2.

without relative consequence. The consumer fraud at the center of the *In re Fusion Connect* case is indicative of a larger problem within the telecommunications industry. Among the most common fraudulent activities committed against consumers by telecommunications providers are known by their industry terms, "slamming" and "cramming."[133] "Slamming" describes the fraudulent practice of changing consumers' long distance carriers without their authorization and without proper verification.[134] The harm received by the victims of this activity comes in the form of "cramming," where consumers are charged for the long distance services and fees they did not authorize.[135] Many consumers do not become aware of their injury until they receive their telephone bills.[136]

Statistics regarding these consumer fraud practices in the telecommunications industry are staggering. Every few years, the FTC conducts a report on consumer fraud in the United States.[137] The most recent study in 2017 found that as many as 2.4 million Americans were victims of unauthorized billing for Internet services.[138] In addition, as many as 3.7 million Americans were victims of unauthorized billing or payment for cell phone services.[139] And the FCC separately estimates that tens of millions of American households have been injured from cramming alone.[140] Sadly, many of the perpetrators are trusted carriers. In 2019, AT&T settled with the FTC to refund its consumers $60 million for misrepresenting services.[141]

133. *See* Ian D. Volner, *FCC Tackles "Slamming and Cramming"*, VENABLE (Aug. 8, 2018), https://www.allaboutadvertisinglaw.com/2018/08/fcc-tackles-slamming-and-cramming.html [https://perma.cc/4K34-4XXK].

134. *Id.*

135. *Id.*

136. *See* FCC, CONSUMER GUIDE: UNDERSTANDING YOUR TELEPHONE BILL 1 (2019) [hereinafter UNDERSTANDING YOUR TELEPHONE BILL], https://www.fcc.gov/sites/default/files/understanding_your_telephone_bill.pdf [https://perma.cc/Y79Z-FN4B].

137. *See* FED. TRADE COMM'N, CONSUMER FRAUD IN THE UNITED STATES: AN FTC SURVEY (2004), https://www.ftc.gov/sites/default/files/documents/reports/consumer-fraud-united-states-ftc-survey/040805confraudrpt.pdf [https://perma.cc/DTW2-M6ZN]; *see* FED. TRADE COMM'N, CONSUMER FRAUD IN THE UNITED STATES: THE SECOND FTC SURVEY (2007), https://www.ftc.gov/sites/default/files/documents/reports/consumer-fraud-united-states-second-federal-trade-commission-survey-staff-report-federal-trade/fraud.pdf [https://perma.cc/SSE7-LEQA]; *see* FED. TRADE COMM'N, CONSUMER FRAUD IN THE UNITED STATES, 2011: THE THIRD FTC SURVEY (2011), https://www.ftc.gov/sites/default/files/documents/reports/consumer-fraud-united-states-2011-third-ftc-survey/130419fraudsurvey_0.pdf [https://perma.cc/5WQG-EFNC]; *see* FED. TRADE COMM'N, MASS MARKET CONSUMER FRAUD IN THE UNITED STATES: A 2017 UPDATE (2017) [hereinafter MASS MARKET CONSUMER FRAUD], https://www.ftc.gov/system/files/documents/reports/mass-market-consumer-fraud-united-states-2017-update/p105502massmarketconsumerfraud2017report.pdf [https://perma.cc/S8RE-B6HT].

138. MASS MARKET CONSUMER FRAUD, *supra* note 137, at 25.

139. *Id.*

140. *See* UNDERSTANDING YOUR TELEPHONE BILL, *supra* note 136, at 1.

141. Press Release, Fed. Trade Comm'n, AT&T Promises to Pay $60 Million to Resolve FTC Allegations It Misled Consumers with 'Unlimited Data' Promises (Nov. 5, 2019), https://www.ftc.gov/news-events/news/press-releases/2019/11/att-pay-60-million-resolve-ftc-allegations-it-misled-consumers-unlimited-data-promises [https://perma.cc/ACK2-2PA2].

Earlier in 2014, the FTC forced the corporation to pay its consumers a total of $105 million as part of a multi-agency settlement for unauthorized billing practices.[142] And in 2014, T-Mobile settled an FCC cramming investigation for $90 million.[143]

What these studies and settlements reveal is that consumer fraud in the telecommunications industry is constantly evolving and continuously perpetrated by the same players. This means a given consumer can be victimized multiple times across different providers and is constantly at risk of injury by fraud. Though the FCC and FTC have levied hefty penalties against these corporations, they have done little to eliminate the activity and the reality of the injuries. With little respect for the enforcement sanctions of these government agencies, it is not out of the question that these companies might entertain bankruptcy offloading to shift future liability for these penalties in debtor-friendly bankruptcy forums. What is needed is a solution that not only disincentives this temptation but also galvanizes the FCC and FTC's ability to collect their judgments and curb mass market consumer fraud.

III. ANALYSIS

A. A Two-Pronged Legal Solution

The concerns raised by the potential dischargeability of FCC and FTC consumer fraud penalties are twofold. The first concern is that telecommunications companies will begin to repeatedly deploy strategic offloading as a measure to escape repercussions for their consumer fraud. The second concern is that if the FCC and FTC cannot collect their monetary penalties across all jurisdictions because their claims are dischargeable, rampant consumer fraud in the telecommunications industry will persist. The only way to solve these problems is to give these agencies some bite behind their practical ability to collect fines. The gazelles need to fear the lion's roar again. Therefore, the best legal solution will primarily employ drafting mechanisms and settled bankruptcy law across all jurisdictions to address both the offloading and dischargeability concerns.

The solution's two-pronged approach was designed with the public's interest in mind. Disincentivizing bankruptcy offloads is arguably more important than protecting the FCC and FTC's ability to fully recover their penalties disputed in bankruptcy. The solution is not a mechanism designed to deny telecommunications companies their rights to seek bankruptcy protection and relief. The following solution is largely built on the premise

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142. Press Release, Fed. Trade Comm'n, AT&T to Pay $80 Million to FTC for Consumer Refunds in Mobile Cramming Case (Oct. 8, 2014), https://www.ftc.gov/news-events/news/press-releases/2014/10/att-pay-80-million-ftc-consumer-refunds-mobile-cramming-case [https://perma.cc/WZ8W-34CD].

143. Press Release, Fed. Trade Comm'n, T-Mobile to Pay at Least $90 Million, Including Full Consumer Refunds To Settle FTC Mobile Cramming Case (Dec. 19, 2014), https://www.ftc.gov/news-events/press-releases/2014/12/t-mobile-pay-least-90-million-including-full-consumer-refunds [https://perma.cc/U2PR-X7TY].

that an FCC or FTC penalty for consumer fraud should never even remotely incentivize bankruptcy in the first place.

There is an inherent tradeoff between protecting the government's interest and creating inefficiencies within bankruptcy reorganizations. The best way to protect the FCC and FTC's penalties in bankruptcy is by restructuring future penalties into secured claims. However, given the scale of these consumer fraud penalties, such secured claims would impair many creditors who would otherwise have been unimpaired due to the absolute priority rule.[144] In other words, the government is protected at the market's expense. This is a tremendous inefficiency that cannot be bypassed. Accordingly, the following solution separately addresses both the disincentivization of bankruptcy offloads and discharge concerns. By this approach, the solution is a mechanism that better serves the FCC and FTC's practical ability to collect their fines outside of bankruptcy.

Additionally, this Note's proposed solution is limited only to FCC and FTC fines levied via consent decrees and does not examine fines imposed by forfeiture orders. This maintains the solution's focus within the fact pattern of the problem identified by the *In re Fusion Connect* saga, which concerned an unsecured penalty imposed by an FCC consent decree.[145] Despite this narrow focus, penalties levied via forfeiture orders may give rise to the same offload and discharge concerns. For instance, FCC forfeiture orders are also generally unsecured arrangements.[146] As such, the following solution, while tailored to consent decrees, can be applied to other enforcement mechanisms imposing a monetary penalty. Ultimately, it encourages FCC and FTC practitioners to reconsider how they draft and structure two main enforcement principles, namely their assignment provisions and their claim interest status. And while these concepts are narrow, they can be broadly applied to forfeiture orders and other enforcement vehicles at the FCC and FTC's disposal.

B. Addressing Offloading Concerns

Bankruptcy offloading concerns will best be addressed through drafting modifications to the FCC and FTC's current consent decree standards. The FCC and FTC issue consent decrees (also known as consent orders) to resolve

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144. *See generally* 11 U.S.C. § 1129.

145. *See In re* Fusion Connect, Inc., 617 B.R. 36, 38-39 (Bankr. S.D.N.Y. 2020), *rev'd*, 634 B.R. 22 (S.D.N.Y. 2021).

146. *See, e.g.*, Mega Moo Radio Co., *Forfeiture Order*, DA 22-199, paras. 7-8 (2022), https://www.fcc.gov/document/forfeiture-order-issued-mega-moo-radio-co [https://perma.cc/78S2-2AJD] (document available for PDF download at linked webpage); *see also* Tele Circuit Network Corp., *Forfeiture Order*, 36 FCC Rcd 7664 (11), paras. 54-55 (2021), https://www.fcc.gov/document/fcc-fines-tele-circuit-4145000-cramming-slamming-violations-0 [https://perma.cc/DB3F-7X96] (document available for PDF download at linked webpage).

investigations against companies accused of committing consumer fraud.[147] These agreements contain the findings of the investigations and stipulate the terms of any penalties levied as remedy.[148] While each consent decree contains detailed provisions tailored to the circumstances of each investigation, they also include boilerplate language that could better serve to protect the government's interests.[149]

The FCC and FTC can improve the way they draft their boilerplate provisions for assignments to deter larger telecommunications providers from pursuing bankruptcy spinoffs. FCC consent decrees usually contain a standard covenant stating "[X Corporation] agrees that the provisions of this Consent Decree shall be binding on its successors, assignees, and transferees."[150] This language was designed to ensure that the government's claim against the company would survive any corporate merger, sale, or acquisition.[151] In fact, this was the same mechanism that shifted Birch Communications' FCC consumer fraud penalty onto Fusion Connect's balance sheet.[152] Alternatively, the FTC addresses assignments by including the penalized corporation's "successors and assigns" within the definition of the consent decree's "Respondents."[153] While these provisions are clearly useful, they should be more nuanced. An ideal covenant would prevent the penalized company from offloading the penalty onto a subsidiary under its own umbrella or a divested spinoff. An ideal covenant would also limit the company's ability to transfer the bill for the penalty to an adjacent third party. Essentially, the consent decree should only permit the penalty's movement to upward assignment along the chain of ownership, not downward or lateral.

Such modification frustrates the business incentive that would drive a penalized company to entertain a strategic offloading as an attractive measure to erase the fine. There is no material benefit to keeping a government penalty on a company's balance sheet. For instance, there are no tax deduction benefits associated with government fines, and without this tax liability offset, the penalty is fully realized.[154] A basic understanding of accounting informs

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147. *See, e.g.*, Birch Communications Inc., *Consent Decree*, 31 FCC Rcd 13510 (16), para. 1 (2016) [hereinafter *Birch Communications Consent Decree*], https://www.fcc.gov/document/birch-communications-inc-1 [https://perma.cc/WA9J-9KEM] (document available for PDF download at linked webpage); *see also* Turn Inc., *Decision and Order*, Dkt. No. C-4612, at 1 (2016) [hereinafter *Turn Inc. Decision and Order*], https://www.ftc.gov/system/files/documents/cases/152_3099_c4612_turn_decision_and_order.pdf [https://perma.cc/7NEY-CG84] (forming the basis of the terms underlying the accompanying consent order, *see* Turn Inc., *Consent Order*, File No. 1523099, at 1 (2016), https://www.ftc.gov/system/files/documents/cases/161214_turn_agreement.pdf [https://perma.cc/VSY5-MGHY]).

148. *See, e.g.*, *Birch Communications Consent Decree*, *supra* note 147, *passim*; *see also Turn Inc. Decision and Order*, *supra* note 147, *passim*.

149. *See generally Birch Communications Consent Decree*, *supra* note 147, *passim*; *see also Turn Inc. Decision and Order*, *supra* note 147, *passim*.

150. *E.g., Birch Communications Consent Decree*, *supra* note 147, at para. 28.

151. *In re* Fusion Connect, Inc., 617 B.R. 36, 39 (Bankr. S.D.N.Y. 2020), *rev'd*, 634 B.R. 22 (S.D.N.Y. 2021).

152. *See id.*

153. *See, e.g.*, *Turn Inc. Decision and Order*, *supra* note 147, at 3.

154. *See* 26 U.S.C. § 162(f).

that this reduces owner's equity.[155] Shareholders will have greater cause for irritation, not only because of the reduced value of their investments, but also because of the business' poor standing in Environmental, Social, and Governance (ESG) evaluations.[156] With such pressures across corporate America, incentivizing telecommunications providers to timely pay their penalties in full will discourage the accumulation of future penalties over time.

C. Addressing Discharge Concerns

Bankruptcy discharge concerns will also best be addressed through drafting modifications to the consent decrees. However, this requires a more complex modification than what was sufficient to address strategic offloading concerns. As discussed earlier, bankruptcy rights cannot be waived away like the assignment of a debt, otherwise, as the Ninth Circuit rationalized, "astute creditors would routinely require their debtors to waive."[157] Likewise, the consent decree cannot simply stipulate that the penalties are nondischargeable.[158] Additionally, continuing to argue nondischargeability on Section 523(a)(2)(A) grounds would require the FCC and FTC to account for the disagreement on this statute's application. This would impractically necessitate that the agencies identify how they are materially injured by a given consumer fraud, and that would be difficult if not specifically detailed in the consent decree. Any injury would be difficult to quantify and may not hold up across circuits. And because Congress narrowly limited which exceptions to discharge apply to corporations under Section 1141(d)(6)(a) of the Code, many Section 523 exceptions are defanged.[159] For example, arguing that a consumer fraud penalty is nondischargeable under Section 523(a)(7) because it is "a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit . . ."[160] will be ineffective because this exception only applies to individual debtors.[161] Therefore, the more efficient legal solution would be for the FCC and FTC to structure their consent decrees in such a way that renders the agencies as secured creditors to the penalized corporation.

Consent decrees' penalty provisions already behave like debt agreements. They set the civil penalties' total monetary amounts, the term installments over which the penalties will be paid, and the modes of

155. Adam Hayes, *Expanded Accounting Equation: Definition, Formula, How It Works*, INVESTOPEDIA, https://www.investopedia.com/terms/e/expanded-accounting-equation.asp [https://perma.cc/LE2S-FKJL] (last updated July 13, 2022).

156. *See generally What Is Environmental, Social, and Governance (ESG) Investing?*, INVESTOPEDIA, https://www.investopedia.com/terms/e/environmental-social-and-governance-esg-criteria.asp [https://perma.cc/L6EK-FDRG] (last updated Sept. 27, 2022).

157. *In re* Thorpe Insulation Co., 671 F.3d 1011, 1026 (9th Cir. 2012) (quoting Bank of China v. Huang (*In re Huang*), 275 F.3d 1173, 1177 (9th Cir. 2002)).

158. *See id.*

159. 11 U.S.C. § 1141(d)(6)(a).

160. 11 U.S.C. § 523(a)(7).

161. 11 U.S.C. § 1141(d)(6)(a).

payment.[162] In fact, consent decrees sometimes specify that the penalties shall be treated as "claims" and "debts" as those terms are defined under Section 3701(b)(1) of the Debt Collection Improvement Act of 1996.[163] Pursuant to that statute, "the term 'claim' or 'debt' means any amount of funds or property that has been determined by an appropriate official of the Federal Government to be owed to the United States by a person, organization, or entity other than another Federal agency."[164] The statute specifically encompasses "any fines or penalties assessed by an agency."[165]

In choosing a property to attach to the penalty, many reasons point to FCC licenses as the most appropriate option. The first reason is that FCC licenses are highly valuable assets that a telecommunications provider would prefer not to surrender. Telecommunications providers have spent billions of dollars on their spectrum empires, indicating that such a loss of this property would directly injure their business operations.[166] This would highly disincentivize a company's default on its penalty payments. In addition, FCC licenses are intangible assets that do not carry the burdens of depreciation, administrability costs, and maintenance that come inherent to the surrender and auction of tangible and real property. The FCC already enjoys a Nobel Prize-winning, highly efficient, and lucrative auctioning infrastructure for its licenses.[167] Any forfeited licenses could easily be auctioned back on the open market to recover the unrealized proceeds (and potentially more) from a default on the payment terms of the consent decree.

Despite the many benefits of securing consumer fraud penalties with FCC licenses, there are a few unique qualities about these licenses that require additional attention. Practitioners may initially raise concerns that the FCC has previously stated that the Federal Communications Act of 1934 generally prohibits the creation of security interests in FCC licenses.[168] However, the applicable statute provides as follows: "No . . . station license, or any rights thereunder, shall be transferred, assigned, or disposed of in any manner, . . . or by transfer of control of any corporation holding such permit or license, to any person except upon application to the Commission and upon finding by the Commission that the public interest, convenience, and necessity will be

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162. *E.g., Birch Communications Consent Decree*, *supra* note 147, at para. 22.

163. *E.g.,* Assurance Wireless USA, LP, f/k/a Virgin Mobile USA, LP, Sprint Corp., and T-Mobile US, Inc., *Consent Decree*, 35 FCC Rcd 12679 (16), para. 24 (2020), https://www.fcc.gov/document/fcc-reaches-200-million-settlement-sprint-lifeline-investigation [https://perma.cc/9PLE-GELN].

164. 31 U.S.C. § 3701(b)(1).

165. 31 U.S.C. § 3701(b)(1)(F).

166. *See, e.g.*, Emma Roth, *AT&T, Dish, and T-Mobile Spend Billions on More 5G Spectrum*, VERGE (Jan. 15, 2022, 3:29 PM), https://www.theverge.com/2022/1/15/22885320/att-dish-tmobile-5g-spectrum-billions-auction [https://perma.cc/DX8C-QBUA].

167. *See* Taylor Kubota, *The Economic Science Behind Wilson's and Milgrom's Nobel Prize*, STAN. NEWS (Oct. 12, 2020), https://news.stanford.edu/2020/10/12/economic-science-behind-wilsons-milgroms-nobel-prize/ [https://perma.cc/V6GM-R7K4].

168. *See* Kirk Merkley, *Memorandum Opinion and Order*, 94 F.C.C. 2d 829, 831, 839 (1983) [hereinafter *Kirk Merkley Memorandum Opinion and Order*] (acknowledging the FCC's general recognition of security interests in FCC licenses as "contrary to established law and policy" under the 47 U.S.C. § 310(d)).

served thereby."[169] This statute effectively conditions the attachment of a security interest in an FCC license on the FCC's approval.[170] This condition was originally intended to protect licensee independence and prevent licenses from falling under the ownership of ineligible license holders, such as financial institutions and foreign entities.[171] Accordingly, if the FCC or FTC were to secure their civil penalties with FCC licenses, the only legal barrier to these agreements would be the FCC's own approval. Surely the FCC would recognize the public benefit this proposed resolution seeks to bestow. Therefore, this question should not be cause for much further concern.

Perhaps the most difficult legal question surrounding the use of FCC licenses to secure civil penalties is how to attach a license that is comparable to the value of the penalty. Any telecommunications provider holds many FCC licenses ranging in bands and value.[172] These licenses are acquired over many years and purchased at auction over a wide range of winning bids.[173] Many extrinsic factors went into these purchase prices, including market competition and consumer demand.[174] While a security interest's collateral need not match the value of the debt, the Code provides that a creditor's claim may bifurcate into a secured claim up to the value of the security interest and a general unsecured claim for the remainder.[175] But creditors can often request a pledge of collateral that exceeds the value of the debt if there are high risks involved in the transaction.[176] Similarly, the FCC and FTC may justify a pledge of collateral that exceeds the value of their penalties because the penalties were procured by a violation of federal law. As a standard policy, the agencies may consider requiring a penalized company to pledge an FCC license or package of FCC licenses that was purchased at a price no less than the amount of the penalty and no more than a certain percentage premium to that amount. The buffer would have to fall into a reasonable range so as to remain within common market practices and any existing legal limits. The FCC and FTC may also consider specifying that the penalized company pledge as collateral the FCC license or package of FCC licenses most recently purchased from the execution of the consent decree that satisfies this value condition. While there may be a more economical or equitable way to structure these terms, these proposals serve as reasonable suggestions and springboards for thought.

Assuming the FCC licenses are successfully attached pursuant to the terms of the consent decree, the civil penalty is adequately shielded from

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169. 47 U.S.C. § 310(d).

170. *See id.*

171. *See Kirk Merkley Memorandum Opinion and Order*, *supra* note 168, at 830-31.

172. *See generally* 19 FCC MOBILE WIRELESS SERVICES COMPETITION ANN. REP. 39-43 (2016),
https://www.fcc.gov/document/19th-mobile-wireless-competition-report
[https://perma.cc/HFW5-9Z59] (report available for PDF download at linked webpage).

173. *See generally id.*

174. *See generally id.*

175. 11 U.S.C. § 506(a)(1).

176. *See* Will Kenton, *Over-Collateralization (OC)*, INVESTOPEDIA, https://www.investopedia.com/terms/o/overcollateralization.asp [https://perma.cc/7RZ7-TTEF] (last updated May 18, 2020).

discharge in bankruptcy. The Code provides that secured creditors in a Chapter 11 reorganization plan cannot have their claims discharged by the debtor corporation without the debtor's surrender of the attached collateral.[177] At worst, the terms of penalty may be renegotiated to better accommodate the distressed company's plan of reorganization.[178] In this case, that might mean a lengthened term or a reduced penalty. If the company's reorganization fails and results in liquidation, the penalty's secured status at least renders it superior to nearly all other debts, essentially guaranteeing the penalty's full payment from the proceeds of the short sale.[179] Either way, attaching a security interest to the penalty offers the FCC and FTC greater protection of their practical ability to collect their fines tied up in bankruptcy. And this mechanism holds across all bankruptcy jurisdictions.

IV. CONCLUSION

This Note is intended to show how the FCC and FTC could apply bankruptcy law mechanisms to not only protect their consumer fraud penalties disputed in Chapter 11 reorganization but also strengthen their overall ability to collect fines and enforce authority. This is an important time for practitioners to consider the potential problems identified by this Note. Bankruptcy may be a niche area of law, but its effects touch all aspects of business, regulation, and enforcement. This Note's solution attempts to balance those considerations and hopes that in time the FCC and FTC will heed this warning for some added security.

177. *See* 11 U.S.C. § 1129(b)(2)(A)(i).
178. *See* 11 U.S.C. § 1123.
179. *See id.*