

Electricity Providers to Claim Administrative Expense

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In Addition to Natural Gas Providers and Water Providers, Bankruptcy Courts Are Now Allowing Electricity Providers to Claim Administrative Expense Status Under Section 503(b)(9) of the Bankruptcy Code

Recent case law may allow electricity providers to benefit from a payment priority for the value of electricity provided to a bankrupt debtor during the twenty (20) days preceding the date of the debtor's bankruptcy filing (the "Petition Date"). Section 503(b)(9) of the Bankruptcy Code creates a priority administrative expense claim for the value of goods received by a debtor in the ordinary course of business during the twenty (20) days prior to the Petition Date. This administrative priority offers an increased likelihood of recovery for a creditor because, under the Bankruptcy Code's priority scheme, which governs the order and distribution of payments to creditors, an administrative expense claim has priority over most other claims.[1]

The key inquiry in deciding whether a creditor is eligible for administrative priority under section 503(b)(9) of the Bankruptcy Code is whether the creditor has supplied the debtor with "goods" during the twenty (20) days preceding the Petition Date. Since the Bankruptcy Code does not define "goods", the vast majority of courts to consider whether electricity constitutes a "good" under section 503(b)(9) of the Bankruptcy Code have applied the Uniform Commercial Code's ("UCC") definition of "goods" – "all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale . . ."[2]

Some bankruptcy courts have found that electricity constitutes a "good" under the UCC. Thus, these courts have allowed electricity providers to take advantage of the priority administrative expense claim under section 503(b)(9) of the Bankruptcy Code.[3] As a result of this recent trend, electricity providers may be able to increase their recovery in a customer's bankruptcy case by submitting a request for payment under section 503(b)(9) of the Bankruptcy Code for the electricity ("goods") received by the customer debtor during the twenty (20) days prior to the Petition Date. In addition to making a section 503(b)(9) claim, an electricity provider may still submit a general proof of unsecured claim in order to receive its share of payments being made to general unsecured creditors in the debtor's bankruptcy case.

The recent decisions that have determined that electricity is a "good" under the UCC, are consistent with case law allowing natural gas providers and water providers to benefit from a priority administrative expense claim under section 503(b)(9) of the Bankruptcy Code.

Recent Trend: Electricity Is a “Good” under Section 503(b)(9)

Virtually every court that has considered whether electricity constitutes a good under section 503(b)(9) of the Bankruptcy Code has utilized the UCC’s definition of goods, which as noted above defines goods as all things “which are moveable at the time of identification to the contract for sale . . .”[4] Thus, courts considering the issue have focused on and analyzed the “movability” and “identifiability” of electricity.

In *Erving Industries*, the United States Court of Appeals for the First Circuit, the only Circuit court that has considered this issue, held that electricity, as a tangible commodity that possesses physical properties, meets the movability and identifiability requirements under UCC section 2-105(2).[5] The court’s holding was based on its finding that electricity moves until it reaches the product sought to be electrified and is therefore movable at the time it is identified to the contract. Accordingly, the *Erving Industries* court found that electricity constitutes a “good” under section 503(b)(9) of the Bankruptcy Code and is eligible for a priority administrative expense claim.[6]

Similarly, in *Grede Foundries*, the Bankruptcy Court for the Western District of Wisconsin determined that electricity was identified to the contract at the moment it was metered, and not at the time of contract formation, because only the electricity that was metered was actually sold to the debtor.[7] The court rejected the debtor’s argument that the electricity was instantaneously consumed once it was metered and was therefore immovable, holding instead that electricity is movable at the time of identification to the contract. As such, the court held that electricity is a “good” under the UCC subject to section 503(b)(9). On appeal, the District Court for the Western District of Wisconsin upheld the bankruptcy court’s holding, reasoning that “electricity is movable, tangible and consumable, . . . it has physical properties, . . . it is bought and sold in the marketplace and thus, . . . it qualifies as a good for purposes of the UCC and the Bankruptcy Code.”[8]

Most recently, in *Southern Montana Elec. Gen. and Transmission Coop.*, the Bankruptcy Court for the District of Montana also held that electricity is good under section 503(b)(9) of the Bankruptcy Code, possibly giving rise to a priority administrative expense claim. That case involved the sale of electricity by an electricity supplier to the debtor (a rural utilities service finance electric cooperative) that provided wholesale electric energy and related transmission services to five electric distribution cooperatives and one municipal utility. In holding that electricity was a “good,” the Bankruptcy Court for the District of Montana adopted in full the *Grede Foundries*’ court’s holding and analysis.[9]

Possible Limits on Recent Trend

It is well settled that section 503(b)(9) does not provide priority status to claims for “services” rendered – the statute refers only to “the value of goods.” Therefore, as a threshold matter, the First Circuit in *Erving Industries* first addressed whether the electricity provider was providing a “service” to the debtor, which would not be covered by section 503(b)(9).

The electricity provider in *Erving Industries* was a “competitive supplier,” which the court held was in the business of selling electricity rather than providing a service. The Court’s holding was based in part on Massachusetts’s

deregulated electric industry, in which “customers are able to purchase generation services from entities other than their traditional electric companies, and the prices charged by those competitive suppliers are not regulated by the Department. . . . Customers’ electricity bills are itemized and separated into distribution, transmission, energy use, and other charges; customers who purchase electricity from a competitive supplier may request separate billings from the electricity supplier and the local utility company.”[10] The Court found that the creditor acted as a competitive supplier within this framework since it contracts with electricity generators to buy electricity and then sells that electricity to customers, who are then responsible for contracting with the local distribution utility to have electricity delivered to the customer’s location.[11]

The court rejected the debtor’s argument that the creditor was a “utility” which by definition provided a service. While undefined in the Bankruptcy Code, the Court noted that a “utility” typically refers to “a ‘business organization ([such] as an electric company) performing a public service and subject to special governmental regulation,’ that has ‘some special position with respect to the debtor,’ and has ‘a monopoly in the area so that the debtor cannot easily obtain comparable service from another.’”[12] In *Erving Industries*, the creditor was not a traditional utility provider because it was not subject to governmental regulation, was not listed on the state’s index of public utility service providers, and did not enjoy a special relationship to the debtor. For these reasons, the Court concluded that the creditor was not a utility and its claim did not arise from services provided to the debtor, but solely from the sale of electricity.[13]

The First Circuit’s holding in *Erving Industries* suggests a potential limitation that would prevent “traditional” transmission and distribution utilities from benefiting from a priority administrative expense claim under section 503(b)(9) for the sale of electricity to a debtor. At the very least, *Erving Industries* implies that under a deregulated framework, a traditional transmission and distribution utility would only be able to claim a priority administrative expense claim for the electric supply portion of the electricity bill.

The debtor in *Grede Foundries, Inc.* made exactly this argument – that the creditor should not receive administrative priority for the full amount of the electric bills because the electricity was a relatively small portion of the utilities’ bill when compared to the transmission, substation, distribution, metering and other customer service components bundled in the utilities’ charges.[14] However, the bankruptcy court (and the district court on appeal) disregarded this argument because it was raised for the first time in a reply brief.[15] While the electric utility, in that case, was allowed to receive administrative priority for the full amount of the electric bill, this issue remains unsettled.

Departure from Prior Case Law

The recent case law trend holding that electricity is a “good” for purposes of section 503(b)(9) of the Bankruptcy Code is a departure from earlier cases holding that electricity does not fit within the definition of “goods.”[16]

The earlier court decisions holding that electricity is not a “good” under the UCC were based on a variety of different grounds. In *Samaritan Alliance*, the court held that an electric utility was not entitled to an administrative claim for the value of electricity because the electricity provided by the utility was more properly characterized as a “service.”[17] In *Pilgrim’s Pride*, the court considered whether trucking, electric, water and gas

companies were entitled to claims under section 503(b)(9) of the Bankruptcy Code.[18] Applying the UCC definition of “goods”, the court held that electricity is not a “good” because the UCC requires that goods be movable at the time of identification, and electricity is only capable of identification after it has been consumed by the end-user.[19] The court further reasoned that UCC § 2-105 does not suggest an intent to include “goods” that cannot be packaged or handled.[20] In addition, the court noted that priority statutes are to be narrowly construed and, therefore, because the electricity provider does not clearly fit within the requirements of section 503(b)(9) of the Bankruptcy Code, it is not entitled to priority treatment.[21]

Natural Gas and Water

Unlike electricity, there is no split in authority as to whether natural gas and water are “goods” for purposes of section 503(b)(9) of the Bankruptcy Code. The few courts that have considered the issue have held that such commodities are eligible for a priority administrative expense claim based on the value of goods received by the debtor during the twenty (20) days preceding the Petition Date.

In addition to considering whether electricity was good under section 503(b)(9) of the Bankruptcy Code, the *Pilgrim’s Pride* court also considered whether natural gas and water were goods eligible for priority administrative expense claims. However, unlike with electricity, the court determined that natural gas was good under section 503(b)(9). The court held that because natural gas falls within the definition of “goods” under section 2-107 of the UCC, the providers of natural gas were entitled to a priority administrative expense claim for the value of the gas delivered to the debtors during the twenty-day period preceding the Petition Date.[22] For the same reasons, the court held that providers of water were also entitled to a priority administrative expense claim for the value of the water delivered.[23]

The *Pilgrim’s Pride* court, however, determined that the administrative claim is limited to the value of the *goods only* and that the debtor should pay an administrative expense claim for “what it would have cost the Debtors to acquire similar goods.”[24] In the case of natural gas and other commodities, the court suggested that such goods may be valued “based on the price at which it could be purchased during the relevant period on the commodity market.”[25] Thus, as is the case with electricity providers, natural gas and water suppliers may not be able to recover costs associated with the transmission, distribution, and metering of natural gas and water.

In *Plastech Engineered Products, Inc.*, the United States Bankruptcy Court for the Eastern District of Michigan also considered whether a provider of natural gas is entitled to a priority administrative expense claim under section 503(b)(9) of the Bankruptcy Code.[26] In that case, the parties conceded that natural gas is a “good” under the UCC. The debtor, however, argued that providers of gas provided primarily services, not goods, such that the transaction should be treated as one for the provision of services under the predominant purpose test.[27] The court rejected the debtor’s argument that the predominant factor test should be applied to determine whether the transaction is primarily for the sale of goods or for services, reasoning that the only relevant determination under § 503(b)(9) is the value of the “goods” that were delivered, irrespective of whether the contract also called for the delivery and sale of services.[28] Accordingly, the status of natural gas and water as “goods” under the UCC and, therefore, under section 503(b)(9) of the Bankruptcy Code, has been accepted by the courts to consider the issue.

Conclusion

The recent line of cases suggests an emerging trend towards finding electricity to constitute a “good” just as natural gas and water have been found to constitute a good. Since the First Circuit is the only United States Court of Appeals to weigh in on this topic, it is not yet clear whether electricity will be widely considered a “good” such that electricity providers may take advantage of the priority administrative expense claim available under section 503(b)(9) of the Bankruptcy Code. It is also unclear if the administrative priority afforded under section 503(b)(9) of the Bankruptcy Code will be limited to electric supply charges as opposed to the transmission, distribution, metering, and customer service components of an electric bill.

As this area of law continues to develop, providers of electricity, natural gas and water – whether “traditional” utility providers or competitive suppliers – may find it beneficial to preserve their rights by submitting a request for an administrative claim under section 503(b)(9) of the Bankruptcy Code for the value of goods provided during the twenty (20) days preceding the Petition Date while also continuing to submit a proof of general unsecured claim for the entire amount of the claim.

1. See 11 U.S.C. §§ 503(b)(3)(9), 507(a)(2).
2. U.C.C. § 2-105.
3. [See *In re Erving Indus.*, 432 B.R. 354, 356 (1st Cir. 2010); *GFI Wisconsin, Inc., f/k/a Grede Foundries, Inc. v. Reedsburg Utility Commission*, 440 B.R. 791, 804 (W.D. Wisc. 2010); *In re Plastech Engineered Products, Inc.*, 397 B.R. 828, 835 (Bankr. E.D. Mich. 2008); *In re Southern Montana Elec. Gen. and Transmission Coop.*, 2013 Bankr. LEXIS 62, at *13 (Bankr. D. Mont. Jan. 8, 2013).
4. U.C.C. § 2-105.
5. *In re Erving Indus.*, 432 B.R. at 369-370.
6. *Id.*
7. *In re Grede Foundries, Inc.*, 435 B.R. 593 (Bankr. W.D. Wisc. 2010).
8. *GFI Wisconsin, Inc., f/k/a Grede Foundries*, 440 B.R. at 804.
9. See 2013 Bankr. LEXIS 62, at *13 (Bankr. D. Mont. Jan. 8, 2013).
10. *In re Erving Indus.*, 432 B.R. at 361.
11. *Id.* at 362.
12. *Id.* at 363 (quoting *One Stop Realtour Place, Inc. v. Allegiance Telecom, Inc.* (*In re One Stop Realtour Place, Inc.*), 268 B.R. 430, 436-37 (Bankr. E.D. Pa. 2001)).
13. *Id.* at 364.
14. *GFI Wisconsin, Inc., f/k/a Grede Foundries, Inc.*, 440 B.R. at 803.
15. *Id.* at 804. While the court ultimately did not address this issue, importantly it noted that “[j]ust because a seller of goods may also be a utility that is entitled to protection of section 366 for the sale of utility services post-petition to a debtor does not mean it is prohibited from allowance of section 503(b)(9) administrative expense claim A utility provider may provide both goods and services within the meaning of each section.” *Id.* at 801.
16. [16] See *In re Samaritan Alliance, LLC*, 2008 Bankr. LEXIS 1830 (Bankr. D. Ky. 2008); *In re Pilgrim’s Pride Corporation*, 421 B.R. 231 (Bankr. N.D. Tex. 2009).
17. 2008 Bankr. LEXIS 1830 at *9 (Bankr. D. Ky. 2008).
18. 421 B.R. 231 (Bankr. N.D. Tex. 2009).

19. *Id.*
20. *Id.*
21. *Id.* at 240.
22. *Id.* at 241.
23. *Id.* at 242.
24. *Id.* at 243.
25. *Id.* at 243-44.
26. *In re Plastech Engineered Products, Inc.*, 397 B.R. 828 (Bankr. E.D. Mich. 2008)
27. *Id.* at 835.
28. *Id.* at 837.

Practices

- Bankruptcy and Creditors' Rights

Industries

- Business Reorganization and Financial Restructuring

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