

Bruce Nathan, Esq.
and Eric Chafetz, Esq.



More Shocking Developments

On Whether Electricity is a Good Entitled to Section 503(b)(9) Administrative Priority Status

The courts continue to be divided regarding whether electricity is a good that qualifies for priority treatment under Section 503(b)(9) of the Bankruptcy Code.¹ It is not surprising that this issue has been, and will likely continue to be, heavily litigated across the country. The difference between qualifying for treatment as an administrative priority claim under Section 503(b)(9) of the Bankruptcy Code in contrast to treatment as a general unsecured claim cannot be overstated. Holders of administrative claims frequently receive full payment of their claims, while general unsecured creditors regularly receive little or no recovery on their claims.

The U.S. District Court for the Southern District of New York, in *Hudson Energy Services, LLC v. The Great Atlantic & Pacific Tea Company, Inc.* (the “A&P case”), is the most recent court to weigh in on this issue. The court held that it was “far from clear” if electricity is a good and, therefore, Hudson’s claim for the sale of electricity to A&P did not qualify for priority treatment under Section 503(b)(9) of the Bankruptcy Code. The court applied the definition of goods contained in Uniform Commercial Code (“UCC”) Section 2-105(l),

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which includes “all things ... which are moveable at the time of identification to the contract for sale.” The court concluded that the electricity Hudson had sold and provided to A&P was not a good under the UCC’s definition because the electricity was not movable when it was identified to the parties’ contract. The court further concluded that identification occurred not when the electricity had passed through the meter, but afterward when the meter had registered A&P’s use of electricity.

This is clearly not the end of the story should a future court decision disagree with the holding of the A&P court.



Conflicting Views on Electricity as a Good

The court in the A&P case follows the view of one group of courts that electricity does not satisfy the UCC’s definition of goods because the electricity was no longer movable when it was identified to the parties’ contract and the electricity was identified when its use was measured by a meter following the end user’s consumption. The decisions supporting this view include the holdings of the: (i) Bankruptcy Court for the Northern District of Texas in *In re Pilgrim’s Pride Corp.*, (ii) Bankruptcy Court for the Eastern District of Kentucky in *In re Samaritan Alliance LLC.*, and (iii) Bankruptcy Court for the District of Delaware in *In re NE Opco Inc.*

Another group of courts disagree with this line of reasoning and have held that electricity is a good under Section 503(b)(9) because electricity is tangible and capable of being felt, measured and stored. These courts have also noted that electricity satisfies the UCC’s definition of goods since the electricity was still moving through the transmission network when it was identified to the contract of sale, and did not stop moving until it was ultimately used. Moreover, according to these courts, the electricity is identified to the contract at the same time it passes through the meter. Further, electricity is no different than natural gas or water, which clearly fall within the UCC’s definition of goods. The decisions supporting this view include the holdings of the: (i) District Court for the Western District of Wisconsin in *In re Grede Foundries*, (ii) District Court for the Northern District of California in *In re Pacific Gas & Electric Company*, (iii) Bankruptcy Court for the District of Montana in *In re S. Mont. Elec. Generation & Transmission Coop., Inc.*, (iv) Bankruptcy Court for the District of Massachusetts in *In re Erving Industries*, and

(v) Bankruptcy Court for the Eastern District of Louisiana in *In re MBS Management Services, Inc.*

Procedural History

The Great Atlantic & Pacific Tea Company, Inc. and certain affiliates (“A&P”) filed their first Chapter 11 case in December 2010.² During the case, Hudson Energy Services, LLC (“Hudson”) sought allowance of an administrative claim in the amount of \$875,943.90 pursuant to Section 503(b)(9) of the Bankruptcy Code based on electricity that Hudson had sold and provided to A&P during the 20-day period prior to A&P’s Chapter 11 filing. A&P objected to Hudson’s motion, arguing that electricity was not a good and, therefore, was not entitled to administrative priority status under Section 503(b)(9).

The Bankruptcy Court ruled that electricity did not satisfy the UCC’s definition of goods. The electricity Hudson had sold and provided to A&P was not movable when it was identified to the parties’ contract because A&P had previously consumed it. Identification occurred when the electricity was reflected or registered by the meter that measured the amount of electricity A&P had already consumed. In addition, the time between the identification and consumption of the electricity had to be meaningful for the electricity to qualify as a good. That was not present in the A&P case where the electricity’s flow through the meter, A&P’s consumption of the electricity, and the meter’s measurement of A&P’s use of electricity all occurred “nearly simultaneously and at the speed of light.”

The Bankruptcy Court also relied on the principle that administrative claims must be narrowly construed. It was simply inappropriate to grant Hudson an administrative priority claim where, based on the division among the courts, it was far from clear whether electricity is a good. Hudson appealed the Bankruptcy Court’s decision to the District Court.

The A&P District Court’s Decision

The District Court affirmed the Bankruptcy Court’s decision and denied Hudson’s Section 503(b)(9) priority claim. The District Court agreed with the Bankruptcy Court that it was “far from clear” whether the electricity Hudson had sold to A&P was a good. The court found that the electricity did not satisfy the UCC’s definition of goods because A&P had already consumed the electricity prior to its identification to the parties’ contract; and therefore, the electricity was not movable at the time of identification.

In reaching this conclusion, the District Court rejected four arguments made by Hudson. Hudson first argued that the Bankruptcy Court should have followed the holding of the Bankruptcy Court for the District of Massachusetts, in *In re Erving Industries, Inc.*, that electricity is a good entitled to Section 503(b)(9) priority status. Hudson contended that, based on the *Erving Industries* decision, the electricity Hudson had sold to A&P satisfied the UCC’s definition of goods because it was identified to the parties’ contract when it had passed through the meter, and was still moving thereafter. The District Court rejected the conclusion of the *Erving Industries* court that electricity was identified to the contract when it

had passed through the meter and instead agreed with the Bankruptcy Court’s reasoning that identification occurred when A&P’s electricity usage was measured by the meter after the electricity had been consumed, at which point, the electricity was no longer movable.

Hudson contended that the electricity Hudson had sold to A&P satisfied the UCC’s definition of goods because it was identified to the parties’ contract when it had passed through the meter, and was still moving thereafter. The District Court rejected Hudson’s argument.

Hudson next argued that electricity did not move when it had passed through the meter. The District Court observed that the Bankruptcy Court never found that electricity was not moving. Instead, the Bankruptcy Court concluded the electricity had already been consumed at the time it was used and became unmovable by the time it was identified to the contract when the meter had registered its passage and consumption. Hudson then argued that the Bankruptcy Court was wrong when it had held that the electricity A&P had consumed was not identified prior to its consumption. The District Court broke this argument down into two discrete questions. The court first posed a factual question: was the electricity registered by the meter before or after it had been consumed? The court then raised a legal question: when was the electricity identified to the contract under the UCC’s definition of goods?

The District Court determined that A&P had already consumed the electricity prior to when its meter had registered A&P’s consumption of the electricity. The court relied on Hudson’s expert’s testimony that the meter had registered zero at the exact moment the electricity had passed through the meter and the meter would not have shown that electricity had passed through the meter until at least a millisecond after A&P had actually used the electricity.

Likewise, A&P’s expert testified that A&P had consumed the electricity prior to when the meter had actually identified the electricity that had passed through the meter. As a result, it was impossible to record how much electricity had passed through the meter prior to A&P’s consumption of the electricity because (a) the electricity was moving at the speed of light, and (b) metering technology was subject to certain limitations.

The District Court then addressed its second question, when was the electricity identified to the parties’ contract. The court held that the electricity that Hudson had sold to A&P was identified to the contract when it was measured, and the measurement was registered to and displayed by the meter. The court noted that goods are identified to a sale contract when they are designated or acknowledged as the goods referred to in the contract. The electricity Hudson sold and provided to A&P was identified to the parties’ contract when the meter

had recorded the actual amount of electricity A&P used, and not at the moment the electricity had passed through the meter. The court relied on Hudson's fact witness' testimony that Hudson had relied on meter readings to bill its clients, and it would have been impossible to tell how much electricity was provided to any customer, including A&P, without these readings. The court also relied upon Hudson's expert witness' testimony that it was impossible to tell how much electricity had passed through the meter until the meter had measured and subsequently displayed the amount of electricity A&P had consumed, and the meter had read zero at the moment the electricity had passed through it. The District Court then concluded that the electricity had already been consumed and was not moving or movable when A&P's use of the electricity was recorded by the meter and identified to the parties' contract.

Bruce Nathan, Esq. is a partner in the New York office of the law firm of Lowenstein Sandler LLP, practices in the firm's Bankruptcy, Financial Reorganization and Creditors' Rights Group and is a recognized expert on trade creditors' rights and the representation of creditors in bankruptcy and other legal matters. He is a member of NACM and NACM's Government Affairs Committee and is a former member of the Board of Directors of the American Bankruptcy Institute and is a former co-chair of ABI's Unsecured Trade Creditors Committee. Bruce was also the co-chair of the Avoiding Powers Advisory Committee working with ABI's commission to study the reform of Chapter 11. He can be reached via email at bnathan@lowenstein.com.

Eric Chafetz, Esq. is counsel at the law firm of Lowenstein Sandler LLP. He can be reached at echafetz@lowenstein.com.

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Finally, the District Court agreed with the Bankruptcy Court that the principle of narrowly construing administrative priority claims warranted denying administrative priority status under Section 503(b)(9) in favor of Hudson. The District Court, like the Bankruptcy Court, felt it was "far from clear" that electricity is a good because of the uncertainties of the nature of electricity and the division among the courts over whether electricity is a good.

Conclusion

The District Court's decision in the A&P case is the most recent chapter in the long-running saga over whether electricity should be characterized as a good or a service with respect to entitlement to priority status under Section 503(b)(9) of the Bankruptcy Code. Due to the disparate holdings among the courts that have previously addressed this issue, assessing risk when providing electricity to a financially distressed company is very difficult, if not impossible. Until one or more U.S. Circuit Courts of Appeals weighs in on this issue, it is inevitable that costly and unpredictable litigation will continue because there is so much at stake. Indeed, the difference between the potential recovery on account of an administrative priority claim in contrast to a general unsecured claim is simply too great to conclude that this fight is over. ■

1. Section 503(b)(9) of the Bankruptcy Code grants sellers of goods an administrative priority claim for:

...the value of any goods received by the debtor within 20 days before the date of commencement of a case under this title in which the goods have been sold to the debtor in the ordinary course of such debtor's business.

2. The first A&P case concluded successfully with a confirmed Chapter 11 plan of reorganization. A&P filed its second Chapter 11 on July 19, 2015.