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Another Highly Charged Court Decision That Electricity is a “Good” Entitled to Section 503(b)(9) Administrative Priority Status

Litigation over whether a creditor’s claim is entitled to priority status under Section 503(b)(9) of the Bankruptcy Code has yielded “shocking” results. This is particularly so when an electricity supplier, including a utility, asserts a Section 503(b)(9) priority claim for the electricity it had supplied to a debtor within 20 days of the debtor’s bankruptcy filing. Whether or not such a claimant is granted priority status depends on whether electricity is a “good” or a “service” since only “goods” are entitled to administrative priority status under Section 503(b)(9).

The ongoing debate over whether electricity is a good or service for purposes of Section 503(b)(9) has been the subject of conflicting court decisions and a highly “charged” debate. The Bankruptcy Code does not define the term “goods,” and the courts have looked to other sources for an understanding of its meaning in the context of Section 503(b)(9).

Recently, in *In re Escalera Resources Co.*, a Chapter 11 case pending in the United States Bankruptcy Court for the District of Colorado, the bankruptcy court categorized electricity as “goods” based on expert scientific

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testimony regarding electricity’s characteristics. As a result, a utility’s claim for the electricity it had supplied to the debtor within 20 days of the debtor’s bankruptcy filing was granted administrative priority status under Section 503(b)(9) of the Bankruptcy Code.

Section 503(b)(9) of the Bankruptcy Code

Section 503(b)(9) of the Bankruptcy Code grants a goods seller an administrative priority claim for the value of goods sold to the debtor in the ordinary course of such debtor’s business that the debtor had



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received within 20 days of its bankruptcy filing. Section 503(b)(9) priority claims are valuable because they must be paid prior to payment of lower priority unsecured claims, and the Bankruptcy Code requires the full payment of all Section 503(b)(9) claims as a condition for approval of a Chapter 11 plan.

The Two Conflicting Views as to Whether Electricity is a “Good”

There is a roughly equal split among bankruptcy and district courts as to whether electricity is a “good” for purposes of Section 503(b)(9) of the Bankruptcy Code. All courts examining this issue have adopted the definition of “goods” under Article 2, Section 2-105, of the Uniform Commercial Code (“UCC”). The UCC defines “goods” as: (1) things existing and identifiable; (2) movable at the time of identification; and (3) capable of being sold.

One group of courts has 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 because electricity is still moving through the transmission network when it is identified

to the contract of sale and does not stop moving until it is ultimately used. In addition, electricity is identified to the contract when it passes through the meter. The *Escalera Resources* court agreed with this view.

Other courts have followed the contrary view that electricity does not satisfy the UCC's definition of goods because electricity is no longer movable by the time it is identified to the contract between the supplier and end user. Rather, the electricity is identified and measured by the meter after the end user has consumed the electricity.

The *Escalera Resources* Bankruptcy Case

Escalera Resources Co. ("Escalera") is an energy company engaged in the exploration, development, production and sale of natural gas and crude oil in the western United States, with its core operations in Wyoming. On November 5, 2015 (the "Petition Date"), Escalera filed its Chapter 11 case in the United States Bankruptcy Court for the District of Colorado.

PacifiCorp d/b/a Rocky Mountain Power ("PacifiCorp") is a public utility company that supplied Escalera with electricity before and after Escalera's bankruptcy filing. PacifiCorp filed a proof of claim, and then a motion, asserting that it was entitled to an administrative priority claim under Section

503(b)(9) of the Bankruptcy Code in the amount of \$84,253.95 for the value of electricity it had supplied to Escalera during the 20-day period prior to the Petition Date. PacifiCorp argued that electricity is a good and, therefore, is eligible for Section 503(b)(9) priority status.

Escalera contended that PacifiCorp's claim was not entitled to administrative expense priority status under Section 503(b)(9) because electricity is not a "good" under the UCC. The bankruptcy court conducted a trial on whether electricity, which the court called "electrical energy," is a good.

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Evidence Presented at Trial

At trial, PacifiCorp presented proof that the electricity it had supplied to Escalera was measured by actual daily readings of several meters. The meter readings formed the basis for the amounts PacifiCorp had charged Escalera, and the entire amount of PacifiCorp's Section 503(b)(9) claim was comprised of the value of electricity it had provided to Escalera

within 20 days of the Petition Date, rather than service charges, taxes or fees.

PacifiCorp also presented Dr. Shawn Kolitch as an expert in physics. Dr. Kolitch testified that the electricity a utility provides to its customer is more properly described as “electrical energy,” rather than the amorphous term “electricity.” “Electrical energy” is a more specific term that refers to the energy carried by charged particles as they move and better reflects the transaction between a utility company and a customer. Dr. Kolitch also testified that electrical energy passing from a utility to its customer is both identifiable and moving, and therefore, moveable, as it passes through the customer’s meter.

The Bankruptcy Court’s Decision

PacifiCorp proved that it had supplied \$84,253.95 worth of electricity to Escalera within 20 days of the Petition Date. The sole question was whether electricity qualified as “goods” for purposes of Section 503(b)(9) of the Bankruptcy Code. The bankruptcy court held that electricity (which the court referred to as “electrical energy”) is a “good” entitled to administrative expense priority under Section 503(b)(9).

Under the UCC’s definition, “goods” must be things existing and identifiable, movable at the time of identification and capable of being sold.

In reaching this conclusion, the bankruptcy court started with the plain meaning of the word “goods.” Since Section 503(b)(9) does not define “goods,” the court turned to various dictionary definitions of the term, which included “things that have value, whether tangible or not,” “things that are produced for sale,” “commodities” and “personal property.” The court concluded that electricity is a good based on Dr. Kolitch’s testimony that electrical energy has physical characteristics, has value, is a commodity and is tangible, i.e., it can be seen under certain conditions, can be heard humming through transmission wires and can be felt, albeit with risk of shock. Thus, electricity is a good under typical usage and common sense meanings.

The bankruptcy court then analyzed whether electricity falls within the meaning of “goods” under the UCC, which the court adopted as the principal legal definition of goods for determining the applicability of Section 503(b)(9). Again, under the UCC’s definition, “goods” must be things existing and identifiable, movable at the time of identification and capable of being sold. The court accepted Dr. Kolitch’s testimony that (a) electrical energy passing from a utility company to a customer is identifiable; and (b) electrical energy transferred to the customer is by its fundamental nature moving—and therefore movable—at all times, including when it passes through the customer’s electricity meter. Thus, the court held that electricity is goods

under the UCC because it is movable when it is identified to the contract.

The bankruptcy court noted that most courts have ruled that electricity is a “good” according to the UCC. The court then reviewed the split among the bankruptcy and district courts regarding whether electricity is a “good” for purposes of Section 503(b)(9). The bankruptcy court found persuasive the court decisions concluding that electricity is a “good” under the UCC. These courts reasoned that electricity is tangible (it has physical properties), movable (it moves through a network of transmission and distribution systems before reaching the customer) and identifiable (it is measured as it passes through the customer’s meter).

The bankruptcy court rejected several contrary decisions that electricity does not constitute “goods” under the UCC. The court criticized these decisions as based on those courts’ own flawed understanding of—and not on any actual evidence regarding—the physical characteristics of electricity.

Escalera conceded that electricity is a thing that exists, can be identified and is capable of being sold. Escalera argued, however, that electricity is not movable at the time of identification. The bankruptcy court disagreed. Dr. Kolitch had testified that electrical energy is carried by transmission lines from the power plant to the customer, passes through the customer’s electric meter where it is quantified, and then flows through conductors to the customer’s electrical energy consuming devices. Thus, electricity identified at a customer’s meter is moving, and therefore movable, when it is identified, regardless of the fact that it may be consumed just nanoseconds later.

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Based on this evidence, the bankruptcy court held that electricity (or what Dr. Kolitch referred to as “electrical energy”) meets the criteria of “goods” under the UCC. The bankruptcy court then bolstered its conclusion by analyzing and concluding that electricity constitutes “goods” or an equivalent term under federal antitrust law, federal labor law, federal energy regulatory law, state tort law, tax law and international treaties.

The bankruptcy court also held that PacifiCorp’s status as a utility with expanded rights under Section 366 of the Bankruptcy Code, which refers to “utility service,” does not mean that the electricity PacifiCorp had supplied to Escalera was not goods. The court noted that Section 366 does not change goods into services.

Finally, the bankruptcy court rejected the argument that Section 503(b)(9) administrative priority status does not apply to electricity because it is almost immediately con-

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sumed, and, therefore, is not subject to reclamation under Section 546(c). According to the court, Section 503(b)(9) does not limit priority status to only those goods subject to reclamation.

Having found that electricity is “goods” for purposes of Section 503(b)(9) of the Bankruptcy Code, the court granted PacifiCorp’s motion for allowance of its administrative priority claim in the amount of \$84,253.95 for the value of electricity it had supplied to Escalera during the 20-day period prior to the Petition Date.

Conclusion

The *Escalera* decision is notable because of the court’s discussion and analysis of extensive expert scientific testimony

demonstrating that electricity is movable when it is identified. While the issue remains far from settled, the *Escalera* court’s holding that electricity is a good eligible for priority status under Section 503(b)(9) certainly presents well-reasoned arguments for both debtors and trade creditors to consider. ■

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