

Negative “Buzz” for Electricity Suppliers Regarding the Applicability of Section 503(b)(9) Priority



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Trade creditors who are “plugged in” when it comes to bankruptcy surely are fans of section 503(b)(9) of the Bankruptcy Code. In general, claims for goods sold to a debtor before its bankruptcy filing are treated as general unsecured claims at the bottom of the claims priority ladder. However, section 503(b)(9) elevates unsecured claims for the value of goods sold to and received by a debtor in the ordinary course of business within the 20 days before the debtor's bankruptcy filing to administrative expense priority status, near the very top of the claims priority ladder. This statutory priority is intended to incentivize (or, rather, avoid punishing) creditors that continue to supply goods to customers on credit despite the customer's financial distress and impending bankruptcy filing.

The impact of section 503(b)(9) seems simple enough—but, in practice, it often isn't. For example, there has been much litigation and conflicting court decisions over whether electricity can be characterized as a “good,” since only claims arising from the sale of goods are eligible for priority status under section 503(b)(9). The latest “buzz” on this issue is from a recent decision of the U.S. District Court for the

District of Oregon in the Chapter 11 cases of *In re North Pacific Cannery & Packers, Inc., et al.* (“NORPAC”). The district court upheld a bankruptcy court ruling denying a utility's priority claim asserted under section 503(b)(9) for the electricity it had supplied to the debtor because electricity is not a “good.”

The Court Split over Whether Electricity Is a Good

Historically, there has been a roughly equal split among the courts over whether electricity is a “good” for purposes of obtaining priority status under section 503(b)(9) for claims arising from the supply of electricity to a debtor. The Bankruptcy Code does not define “goods.” As a result, bankruptcy courts have generally adopted the definition of “goods” under Article 2 of the Uniform Commercial Code (“UCC”). **Section 2-105(1) of the UCC defines goods as “all things . . . which are movable at the time of identification to the contract for sale.”**

So, whether electricity is a good hinges on whether electricity is movable at the time of identification to the contract of sale of the electricity. **One group of courts has held**

that electricity is a good because electricity is identified to the contract when the electricity passes through a meter—while the electricity is still moving. This group includes courts in Massachusetts (*In re Erving Industries, Inc.*), Wisconsin (*GFI Wisconsin, Inc. f/k/a Grede Foundries Inc. v. Reedsburg Utility Commission*) and Montana (*In re Southern Montana Electric Generation and Transmission Cooperative, Inc.*), and, most recently, the Colorado bankruptcy court in 2017, in *In re Escalera Res. Co.* (“*Escalera*”). In *Escalera*, the debtor did not present an expert witness to rebut the expert testimony presented by the utility provider (which happened to be the same utility provider whose claim was the subject of the *NORPAC* decisions).

Other courts have held that electricity does not satisfy the UCC’s definition of goods because electricity is identified and measured by the meter after the end user has consumed the electricity—after the electricity has stopped moving. This view has been adopted by courts in districts with some of the more historically active commercial bankruptcy dockets in the country—such as the Southern District of New York in 2015 (in *In re Great Atl. & Pac. Tea Co.*), the District of Delaware in 2013 (in *In re NE Opco, Inc.*), and in the Northern District of Texas in 2009 (in *In re Pilgrim’s Pride Corp.*). The Oregon bankruptcy and district courts in *NORPAC* are the latest courts to adopt this view.

Factual Background and the Bankruptcy Court Decision

North Pacific Cannery & Packers (the “Debtor”) filed a Chapter 11 petition on Aug. 22, 2019. PacifiCorp, a public utility that supplied electricity to the Debtor, asserted a claim including a priority claim under section 503(b)(9) in the amount of \$206,009.81 for the electricity PacifiCorp had supplied to the Debtor during the 20 days before the bankruptcy filing. The Debtor sought to reclassify PacifiCorp’s section 503(b)(9) priority claim as a general unsecured claim, arguing electricity is not a “good.”

In support of its section 503(b)(9) claim, PacifiCorp introduced expert testimony that electricity is identified when it passes through the electric meter and while it is

still moving. This was the same expert witness that PacifiCorp had successfully relied on in the *Escalera* case, where the Colorado bankruptcy court held that electricity is a good and granted PacifiCorp priority status under section 503(b)(9).

In *Escalera*, PacifiCorp’s expert witness testimony was un rebutted. However, in the *NORPAC* case, the Debtor introduced its own expert’s testimony that rebutted PacifiCorp’s expert testimony as follows:

1. Electricity is a form of energy transferred via waves that has no mass nor solid form;
2. Electricity travels near the speed of light—much faster than the speed at which a meter can operate; and
3. Electric meters generally can only measure the amount of electricity that passed through them *after* the electricity has been consumed.

The *NORPAC* bankruptcy court ruled that electricity is not a good based on the widely accepted UCC definition of “goods” and the Debtor’s expert testimony. Against the backdrop that goods are things that are *movable* when they are identified, and relying on the Debtor’s expert testimony, the bankruptcy court held:

- Goods are identified when they “are designated, or agreed upon, as the goods to which the contract refers,” and electricity is impossible to identify “until, at the earliest, the quantity of electricity delivered is registered and displayed on the meter.” Electricity moves at nearly the speed of light—much faster than the meter operates—resulting in the meter measuring the amount of electricity that passed through it after the electricity has been consumed. Since by the time the meter actually measures the electricity, it is no longer movable, electricity is not a good as defined by the UCC.¹
- Even if identification occurs when the electricity is moving through the meter (as the Debtor’s expert had testified), electricity still does not qualify as a good because “moving” is not synonymous with “movable.” Although electricity is moving when

it passes through a meter, it can only be consumed by the device that closed the circuit and caused the electricity to flow through the meter. In other words, electricity may be *moving* at that time, but it cannot be moved and therefore is not *movable*. As the bankruptcy court aptly analogized:

“The Earth moves and is moving. So does the wind; as does the Empire State Building in a strong wind. But the Earth and the wind are not ‘movable’ because no one could conceivably move them.”

PacifiCorp appealed the bankruptcy court’s decision to the district court.

The District Court’s Decision

The district court affirmed the bankruptcy court’s holding that electricity is not a good and, as such, is not eligible for priority status under section 503(b)(9). As an initial matter, the district court noted that the UCC’s definition of goods has been widely accepted by the courts, even where electricity has been considered a good—such as in *Escalera*. Accordingly, the district court relied on the UCC definition that goods are “all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale[.]”

The district court affirmed the bankruptcy court’s ruling and held that electricity does not satisfy the UCC’s requirements for goods. The district court was persuaded by the Debtor’s expert testimony that electricity is not movable at the time of its identification to the contract. Because electricity moves at nearly the speed of light, an electric meter does not measure (or, identify) electricity until the end user has already consumed it. By then, the electricity is no longer movable and, as such, is not a good.

The district court noted that in the most recent case to conclude otherwise, *Escalera*, the court had relied on the *unrebutted* testimony of PacifiCorp’s expert. But in the *NORPAC* case, the court had the benefit of the Debtor’s expert testimony that further explained how and when a meter measures electricity. And, the district court concluded

that based on U.S. Supreme Court precedent, any doubt concerning whether an unsecured claim is eligible for priority status “is best resolved in accord with the Bankruptcy Code’s equal distribution aim.” Here, that means erring on the side of treating a utility’s prepetition claim for supplying electricity to the Debtor just like any other run-of-the-mill prepetition claim—as a general unsecured claim.

Conclusion

The *NORPAC* decisions illustrate the split among the courts over the applicability of section 503(b)(9)’s priority status to claims arising from the supply of electricity to a debtor. Since PacifiCorp did not file an appeal from the district court’s ruling in *NORPAC*, more definitive clarity on whether electricity is a good eligible for priority status under section 503(b)(9) will have to come from another case where a U.S. Court of Appeals weighs in on this issue. ■■■■■

- 1 The bankruptcy court rejected an argument by PacifiCorp that electricity qualifies as a good because there is a “theoretical possibility” that AC electricity can be stored in a manner similar to water and natural gas (which are generally considered goods for purposes of section 503(b)(9)). The bankruptcy court distinguished electricity from water and natural gas because water and natural gas are designated as goods under the UCC as “minerals or the like.” Moreover, storage of electricity is uncommon, and there was no evidence that the Debtor had stored the electricity obtained from PacifiCorp.

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