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Utilities after BAPCPA: What's Changed?

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The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), effective for the most part for cases filed after Oct. 16, 2005, brought many changes to the world of bankruptcy practice. It could be safely assumed that utility providers were jumping for joy with the enactment of §366(c) of the Bankruptcy Code, which easily could be read to put utility providers in the driver's seat when negotiating and determining adequate assurance of future payment. Indeed, one bankruptcy court, discussed more fully below, has so held.


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But most bankruptcy courts have not allowed utility providers to dictate the terms of assurance of future payment. It appears that most bankruptcy courts have continued following pre-BAPCPA practice and procedure. This article discusses this difference in practice by first looking at §366 pre- and post-BAPCPA, followed by a discussion of the analysis and holding of *In re Lucre Inc.*,[1] the only published opinion that analyzes the new §366(c). Finally, the article focuses on the bankruptcy case of Storehouse Inc. and the utility procedures established by the debtor-in-possession (DIP) as an example of post-BAPCPA practice.

New Rules under §366

Before BAPCPA was enacted (and became effective), the procedures that a DIP had to follow to maintain its utilities was straightforward. As part of their first-day motions, DIPs routinely filed motions to establish procedures to determine adequate assurances of payment to utilities.

Under §366(a) of the Code, a utility is prohibited from altering, refusing or discontinuing post-petition services "solely on the basis of the commencement of a [bankruptcy] case...or that a debt is owed by the debtor to such utility for service rendered before the order for relief was not paid when due." However, in an effort to protect utility providers, in §366(b) Congress authorized a utility provider to "alter, refuse or discontinue service if neither the trustee nor the debtor, within 20 days after the date of the order for relief, furnishes adequate assurance of payment, in the form of a deposit or other security, for service after such date." Neither §366(a) nor (b) specifically required the DIP to furnish any deposit or any other form of monetary security to satisfy the "adequate assurance of payment" standard in §366(b).

It was common for DIPs who remained current on their pre-petition utility bills to argue that the utility providers already were adequately assured of future payment, and therefore, no deposit or other monetary security was required. Since the DIPs paid their utility bills on time pre-petition, there was no reason to doubt that they would not continue to do so post-petition, according to the DIPs, of course. In addition, DIPs also would argue that the utility providers were entitled to an administrative expense claim in case of nonpayment, and therefore, they were adequately pro-tected.[2]


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With the enactment of BAPCPA, and §366(c) in particular, it appeared that DIPs would not be able to file a routine first-day motion requesting procedures for determining the adequate assurance of payment for utilities. Section 366(c) appeared to give utility service providers additional protections and leverage. This section, which is only applicable in chapter 11 proceedings, provides that:

> a utility referred to in subsection (a) may alter, refuse or discontinue utility service if, during the 30-day period beginning on the date of the filing of the petition, the utility does not receive from the debtor or the trustee adequate assurance of payment for utility service *that is satisfactory to the utility.*[3]

But not only did BAPCPA require that the adequate assurance of payment

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[1] 333 B.R. 151 (Bankr. W.D. Mich. 2005).

[2] *See* 3 King, Lawrence P., Collier on Bankruptcy ¶366.03[1] (15th ed. rev. 2006) ("The legislative history suggests that in some cases, a simple administrative priority will constitute adequate security.").

[3] Emphasis added.

be satisfactory to the utility, it also defined what constitutes adequate assurance of payment. Under new §366(c)(1), and for purposes of that subsection only, assurance of payment is defined as "(1) a cash deposit, (2) a letter of credit, (3) a certificate of deposit, (4) a surety bond, (5) a prepayment of utility consumption or (6) another form of security that is mutually agreed upon between the utility and the debtor or the trustee."[4] Moreover, an administrative expense priority claim is specifically excluded from the definition of "assurance of payment."[5] Congress also provided a procedure for a DIP to modify the utility provider's request for adequate assurance of payment: "On request of a party in interest and after notice and a hearing, the court may order modification of the amount of an assurance of payment under paragraph (2)."[6]

Thus, as stated above, given the plain language of §366(c), the ballgame appeared to change and utility providers could dictate to the DIPs, at least initially, the amount *and* type of security that they wanted.[7] It would be up to a DIP to file a motion under §366(c)(3)(A) requesting modification of that amount.[8] Moreover, the DIP would have to contact all of its utility providers, obtain from them what they thought constituted assurance of payment, and then either meet the utilities' demands or obtain an order within 30 days after the filing of the petition modifying that amount to continue to receive service.

In re Lucre

Surprisingly, there are only a few published opinions discussing §366(c), especially given that it appeared to change utility motions procedurally. Only *In re Lucre Inc.*[9] analyzes the new subsection.[10]

Lucre Inc., a telecommunications provider, filed for chapter 11 on Oct. 21, 2005, just four days after §366(c) became applicable. On the petition date, Lucre received utilities from seven different providers.[11] As to five of those providers, Sprint, Consumers Energy, SBC, Verizon and U.S. Signal, Lucre is the end-user of the services. As to the other two, IXC and Opex, Lucre purchased telecommunication services and then supplied those services to its customers.

Shortly after it filed for chapter 11, Lucre contacted four of the utility providers and offered assurances of payment. Only Opex responded to Lucre's offer and countered by demanding a $4,500 deposit, rather than the $1,000 offered by Lucre.

On Nov. 3, 2005, Lucre filed its "Emergency Motion of Debtor Pursuant to 11 U.S.C. §366 for Authority to Provide Adequate Assurance of Future Performance to Utility Providers."[12] The bankruptcy court granted the emergency motion and held a hearing on Nov. 8, 2005. At the hearing, Lucre went forward with the motion as to Sprint, Consumers Energy, IXC and Opex.

Lucre requested that the bankruptcy court continue the §366(c) injunction as to Sprint, Consumers Energy and IXC because they had failed to respond to its offer of adequate assurance. But the bankruptcy court refused, explaining that subsection (c) of §366 specifically and unequivocally "requires as a condition to continuing the injunction either the utility's acceptance of the adequate assurance offered by the chapter 11 trustee or [DIP] or the chapter 11 trustee's or [DIP's] acceptance of the adequate assurance offered by the utility."[13] Once either of those two conditions occurs, the bankruptcy court explained, the DIP then has a right to have the adequate assurance payment modified by the court.[14] The bankruptcy court further explained that "[i]n other words, the trustee or [DIP] has no recourse to modify the adequate assurance of payment the utility is demanding until the trustee or [DIP] actually accepts what the utility proposes."[15]

Thus, according to the *Lucre* court, the utility provider could demand whatever it wants as adequate assurance of payment and it would be up to the DIP to agree to the request and then and only then seek modification from the bankruptcy court.[16]

In re Storehouse Inc.: An Example of Post-BAPCPA Practice

Practically speaking, despite the addition of subsection (c) to §366, large corporate debtors continue to file first-day motions asking bankruptcy courts to determine adequate assurance of payment for future utility providers. Many utility providers have taken the position—with mixed results—that §366(c) no longer permits a DIP to seek such relief.

For example, in *In re Storehouse Inc.*,[17] the DIP filed a typical pre-BAPCPA first-day pleading seeking, among other things, an interim order prohibiting its utilities from altering, refusing or discontinuing services pending entry of a final order, deeming that the utilities had received adequate assurance of future payment, and establishing procedures for the utilities to request additional adequate assurance and to opt out of the proposed procedures (the "Utility Motion").[18] The DIP did not serve the Utility Motion on any of its utility providers. At the first day hearing, the U.S. Bankruptcy Court for the Eastern District of Virginia entered an interim order approving the Utility Motion,[19] which apparently was served on all utilities by sending a copy of the order to the various Post Office boxes that the DIP had on file.[20] Several utilities objected to the Utility Motion (collectively, the "Objecting Utilities"), arguing that the DIP's proposed procedures were directly contrary §366(c) of the Code.[21]

In support of the Utility Motion, the

4 This definition of assurance of payment does not apply to §366(b); therefore, DIPs can still provide such things as an administrative expense claim as adequate assurance of payment to a utility during the first 20 days of the bankruptcy case.

5 11 U.S.C. §366(c)(1)(B) ("For purposes of this subsection, an administrative expense priority shall not constitute an assurance of payment.").

6 11 U.S.C. §366(c)(3)(A) ("In making the determination under this paragraph whether an assurance of payment is adequate, the court may *not* consider (i) the absence of security before the date of filing of the petition, (ii) the payment by the debtor of charges for utility service in a timely manner before the date of the filing of the petition or (iii) the availability of an administrative expense claim." Thus, some of the arguments that DIPs made pre-BAPCPA were now specifically excluded from any consideration of what constitutes assurance of payment to a utility provider.

7 3 *Collier on Bankruptcy* ¶366.03[2] ("Section 366(c)(2) alters the procedures applicable to the provision of adequate assurance by essentially requiring, in the first instance, that the debtor pay what the utility demands, unless the court orders otherwise.").

8 Interestingly, §366(c)(3) does not state that the bankruptcy court can modify the type of assurance of payment requested by the utility provider.

9 333 B.R. 151 (Bankr. W.D. Mich. 2005).

10 *See, e.g., Darby v. Time Warner Cable Inc. (In re Darby),* 470 F.3d 573, 574 (concluding that a cable operator is not a utility contemplated by §366 of the Code); *In re Astle,* 338 B.R. 855, 859 (Bankr. D. Idaho 2006) (concluding that since the case was filed under chapter 12, §366(c) did not apply).

11 The bankruptcy court did not conduct an analysis concerning whether the seven were in fact utilities for purposes of §366 of the Code. For purposes of this column, we analyze and discuss *In re Lucre* as if the seven were indeed utilities, but do not take a position whether they were in fact utilities.

12 *In re Lucre,* Case No. 05-21732 (Bankr. W.D. Mich. Nov. 3, 2005).

13 *In re Lucre,* 333 B.R. at 154.

14 *Id.*

15 *Id.*

16 The *Lucre* court recognized that utility providers may have a duty to negotiate in good faith when exercising their rights under subsection (c). Thus, if a utility provider refuses to negotiate, the DIP could then file a motion seeking a determination of assurance of payment. If the utility provider requests assurance of payment and the DIP disagrees with the amount, the DIP can always file a request to modify the amount. Thus, the DIP is protected by a utility provider who fails to negotiate and a utility provider who requests a large and unreasonable assurance of payment.

17 Case No. 06-11144-SSM (Bankr. E.D. Va. Sept. 18, 2006).

18 Motion for Interim and Final Orders Determining Adequate Assurance of Payment for Future Utility Services, *In re Storehouse Inc.,* Case No. 06-11144-SSM (Bankr. E.D. Va. Sept. 18, 2006) (Docket No. 22) (hereinafter the "Utility Motion").

19 Interim Order Determining Adequate Assurance of Payment for Future Utility Services, *In re Storehouse Inc.,* Case No. 06-11144-SSM (Bankr. E.D. Va. Sept. 21, 2006) (Docket No. 29).

20 Affidavit of Administar Services Group Inc., Case No. 06-11144-SSM (Bankr. E.D. Va. Sept. 29, 2006) (Docket No. 63).

21 Objection of Certain Utility Companies to Utility Motion, *In re Storehouse Inc.,* Case No. 06-11144-SSM (Bankr. E.D. Va. Oct. 5, 2006) (Docket No. 136); Objection of Alabama Power Company to Utility Motion, *In re Storehouse Inc.,* Case No. 06-11144-SSM (Bankr. E.D. Va. Oct. 11, 2006) (Docket No. 169); Objection of Potomac Electric Power Co., Delmarva Power & Light Co. and Entergy to Utility Motion, *In re Storehouse Inc.,* Case No. 06-11144-SSM (Bankr. E.D. Va. Oct. 11, 2006) (Docket No. 170).

DIP stated that it intended to timely pay all post-petition obligations owed to the utilities, and the DIP already had posted deposits with many of its utilities.[22] Additionally, the DIP would provide a deposit equal to two weeks of service based on the historical average over a 12-month period, *but only if* (1) the utility requested such a deposit in writing and provided specific account information, (2) the utility already did not hold a deposit equal to or greater than such amount and (3) the utility was not paid in advance for its services.[23] Any utility provider that requested and accepted the DIP's two-week deposit was deemed to have received adequate assurance and waived any right to seek additional adequate assurance during the case.[24]

Moreover, the DIP asserted that the revisions to §366 did not limit the bankruptcy court's ability to review and/or determine requests for adequate assurance payments and it did not give utilities the unilateral right to demand satisfactory adequate assurance in their sole discretion and terminate service to a debtor if their demands were not met within the first 30 days of a case.[25] Citing numerous post-BAPCPA cases in which various bankruptcy courts had approved similar procedures, the DIP contended that its process for handling adequate assurance requests was reasonable and that the bankruptcy court was authorized to grant such relief.[26]

The Objecting Utilities argued (citing *In re Lucre*) that the DIP's payment procedures violated the express provisions of revised §366(c) by (1) extending the 20- and 30-day periods in §§366(b) and (c), respectively; (2) making the process of obtaining a deposit time-consuming and burdensome by requiring the utilities to provide account history information and an explanation as to why the DIP's proposed two-week deposit was insufficient; and (3) shifting the burden from the DIP to the utilities by requiring the utilities to request additional adequate assurance from the bankruptcy court rather than the DIP paying the amount requested by the utilities and then the DIP having to go to the bankruptcy court seeking to have such amount modified.

Additionally, the Objecting Utilities asserted that the DIP's "prediction" that it could pay post-petition obligations and the fact that a utility holds a pre-petition deposit specifically could not be considered by the bankruptcy court under §366(c)[27] Finally, all of the Objecting Utilities requested a two-month deposit based on the average number of days the utilities would have delivered service to the DIP prior to being able to terminate service pursuant to state law regulations. In response to the Objecting Utilities' requests for a two-month deposit, the DIP stated that a two-month deposit was unnecessary and unreasonable in this case because the utility expenses would be paid under an agency agreement entered into with a liquidator, and the payment of such expenses by the liquidation agent was secured by an irrevocable and unconditional standby letter of credit.[28]

Twenty-five days after the petition was filed, the bankruptcy court held a final hearing on the objections to the Utility Motion and the Objecting Utilities' requests for additional adequate assurance payments. Although the bankruptcy court overruled the objections, it held that the DIP must provide a one-month security deposit to the Objecting Utilities.[29]

Several of the Objecting Utilities have appealed the bankruptcy court's final order (collectively, the "Appellant Utilities").[30] Among other things, the Appellant Utilities are challenging the DIP's burden-shifting procedures, the DIP's failure to properly serve the Utility Motion and the bankruptcy court's authority to enter an interim order prescribing the terms of utility service an on *ex parte* basis.[31] It is unclear, however, whether the district court will get to hear these issues because all of the Storehouse locations have been closed and all utility service in the DIP's name has been discontinued.[32]

Conclusion

Section 366(c) of the Code appeared to change the way that DIPs and trustees would have to deal with utility providers procedurally. *Lucre* confirmed this. However, the *Storehouse* bankruptcy case and cases cited by the DIP in its motion highlight the fact that bankruptcy courts are not following the *Lucre* interpretation and analysis of §366(c). Bankruptcy courts are instead allowing DIPs to dictate the amount and type of assurance and procedures for obtaining modification of them, and if the utility provider is not satisfied with what the DIP proposes, then it is up to the utility provider to object to the procedures established by the DIP and to request additional assurance of payment.

If bankruptcy courts are going to allow this type of procedure, then perhaps one way to strike a balance would be for bankruptcy courts to require DIPs to serve their utility motions, and any subsequent motions or orders relating to utilities, in accordance with Federal Rule of Bankruptcy Procedure 7004 rather than on the Post Office box where the utility payments are sent.[33] This would give the utility provider better notice and an opportunity to object to the procedures established by the DIP and to contest any adequate assurance of payment proposed by the DIP, especially since these types of motions are usually heard at the beginning of a case. ■

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22 Utility Motion at ¶14-15.

23 *Id.* at ¶16.

24 *Id.*

25 Debtors' Omnibus Response to Objections to the Utility Motion, *In re Storehouse Inc.,* Case No. 06-11144-SSM (Bankr. E.D. Va. Oct. 12, 2006) (Docket No. 192).

26 *Id.* at p. 6 (citing §§366(c)(3) and 105(a) for authority); *see, e.g., In re Calpine Corp.,* Case No. 05-60200 (Bankr. S.D.N.Y. Jan 18, 2006); *In re Three A's Holdings LLC,* Case No. 06-10886 (Bankr. D. Del. Sept. 20, 2006).

27 Objection of Alabama Power Company to Utility Motion at p. 7; *see, also,* 11 U.S.C. §366(c)(3)(B).

28 Debtors' Omnibus Response to Objections to the Utility Motion at p. 9.

29 Final Order Determining Adequate Assurance of Payment for Certain Utilities, *In re Storehouse Inc.,* Case No. 06-11144-SSM (Bankr. E.D. Va. Oct. 23, 2006) (Docket No. 232) (noting that one objection was withdrawn as a result of settlement).

30 Notices of Appeal by Objecting Utilities, *In re Storehouse Inc.,* Case No. 06-11144-SSM (Bankr. E.D. Va. Oct. 30, 2006) (Docket Nos. 310, 311).

31 *See* Appellants' Designations of Items to be Included in Record and Statement of Issues to be Presented, *In re Storehouse Inc.,* Case No. 06-11144-SSM (Bankr. E.D. Va. Nov. 9, 2006) (Docket Nos. 379, 380).

32 *See* Brief in Support of Motion of Storehouse Inc. to Dismiss Appeal as Moot and for Lack of Standing, and to Toll Briefing Schedule, *Potomac Electric Power Co., et al. v. Storehouse Inc. (In re Storehouse Inc.),* Civil Action No. 06-01466-GBL (E.D. Va. Jan. 11, 2007) (Docket No. 4).

33 Bankruptcy Rule 7004 requires service to be made within the United States by first-class mail postage prepaid. When serving a domestic corporation, the motion must be mailed to the attention of "an officer, a managing or general agent, or to any other agent authorized by appointment or law to receive service of process" and not to a P.O. box.