New Bankruptcy Code

All Power to the Utility Companies

By Loren S. Scott, Attorney

When representing a debtor in a *Chapter 11* bankruptcy case, an issue that is easy to overlook or fail to address in the earliest stages of the case is the effect the filing will have on services provided to the debtor by utility companies. Failure to address this issue can result in serious consequences, including the utility company shutting off services to the debtor.

The issue of how to deal with utility services in bankruptcy is addressed in *11 USC § 366,* as recently amended by the *Bankruptcy Abuse Prevention and Consumer Protection Act of 2005* (BAPCPA), but the direction is hazy. Prior to this act, although not completely clear and reliable, the statute was at least predictable as to the hurdles a debtor must meet.

A utility could not alter, refuse, or discontinue service to, or discriminate against, a debtor during the first 20 days after the filing of a bankruptcy case solely on the basis that the debtor filed bankruptcy or is indebted to the utility for service provided pre-petition. The new *Section 366(b)*, however, authorizes a utility to alter, refuse, or discontinue service if the debtor fails to provide the utility with "adequate assurance of payment" for post-petition services within 20 days from the petition date.

In defining "adequate assurance of payment," the former statute merely stated that it could take the form of a deposit or other security. The real definition of "adequate assurance of payment" was left for the courts to decide. Recent decisions have held that granting a utility an administrative expense priority claim may be an adequate assurance of payment if the estate is sufficiently administratively solvent *(in re C.T. Harris, Inc., 295 B.R. 405 (Bankr. M.D. Ga. 2003) and Adelphia Business Solutions, Inc., 280 B.R. 63 (Bankr. S.D.N.Y. 2002*).

Under the old statute, a debtor had only to propose a deposit and/or administrative expense claim to the utility to prevent discontinuation of service. If the utility was unhappy with the "adequate assurance of payment," it could go to court to seek modification.

The *Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, clearly funded in part by a strong lobby from the utility industry, added a new subsection *(c) to § 366* and took this control away from the debtor and placed it in the hands of the utilities. This new subsection added a definition of "assurance of payment," which now means a cash deposit, a letter of credit, a certificate of deposit, a surety bond, a prepayment of utility consumption, or another form of security that is mutually agreed on between the utility and the debtor *(11 U.S.C. § 366(c)(1)(A)).*

That definition expands assurance of payment beyond a deposit or other security but reveals absolutely nothing about the meaning of "adequate." More importantly, *§ 366(c)(1)(B)* provides that an administrative expense priority shall not constitute an assurance of payment. In other words, the debtor must actually come up with some form of cash deposit or security.

What is especially burdensome to debtors is the new subsection *(c)(2)* which provides that, in a *Chapter 11* case, a utility may alter, refuse, of discontinue utility service within 30 days from the petition date if the utility does not receive adequate assurance of payment that is "satisfactory to the utility." In other words, if the utility doesn't like it, it isn't "adequate."

If the utility is not satisfied, it can shut off service and the debtor must go to court to obtain a ruling that the "assurance of payment" was, in fact, adequate. This puts all power in the hands of

the utility companies and forces the debtor to accept what the utility wants—or incur the expense of obtaining a court ruling on an expedited basis.

The Bankruptcy Court for the Western District of Michigan is the only court so far to issue an opinion on this new subsection (see *In re Lucre, Inc., 333 B.R. 151 (Bankr. W.D. Mich. 2005)).* In Lucre, the debtor filed an emergency motion following the filing of the bankruptcy petition seeking to extend the automatic injunction of *§ 366(a)* because the debtor made an offer of adequate assurance and the utility failed to respond (Id. at 152-53).

The court held that it had no discretion to continue the automatic injunction against utilities beyond the 30 day period simply because the utility failed to respond to the debtor's offer of adequate assurance. The adequate assurance of payment offered by the debtor was ruled only to bind the utility to provide service for the 21st through 30th days following the petition date (Id. at 154-5. Beyond the 30th day, if the utility did not accept the assurance of payment offered by the debtor, it could discontinue service.

The court also noted that the debtor had no recourse against the utility for the adequate assurance demanded without first accepting the adequate assurance, and then moving to have that adequate assurance modified by the court (Id. at 154). The court did add, however, that the utility company may have a duty to bargain in good faith with the debtor, and that the debtor may have the ability to enjoin the utility from enforcing its rights under subsection *(c).*

The Lucre case presents a troubling result—the automatic injunction of *§ 366(a)* applies for the first 20 days following the petition date. If the debtor wants to extend the automatic injunction for another 10 days an offer of adequate assurance must be made to the utility. If the debtor wants to extend the automatic injunction past the 30-day period, then the utility must accept the debtor's offer or the debtor must accept the utility's offer.

If the utility does not accept the offer of assurance of payment, the debtor has two choices: 1) accept the utility's offer and file an emergency motion to modify the adequate protection, or 2) file an adversary proceeding for injunctive relief and obtain a hearing on a motion for preliminary injunction before the 30th day following the petition date. If the debtor does not take one of these actions, the automatic injunction of *§ 366(a)* expires and the utility can shut off service.

Under new subsection *(c)(4)*, in determining whether an assurance of payment is adequate, the court may not consider the following factors:

- The absence of security before the petition date
- The timely payment by the debtor before the petition date
- The availability of an administrative expense priority.

Through *§366(c)(1)(B)* and *(4)*, Congress has removed the ability of the debtor to continue the automatic injunction based on the granting of an administrative expense priority, regardless of the administrative solvency of the debtor. The debtor must provide some form of cash deposit or other security that is acceptable to the utility.

In enacting new subsection *(c)* to *§ 366*, Congress took a fairly clear statute which gave debtors a quick determination of adequate assurance of payment, and placed significant new burdens on debtors. It legislatively overruled certain case law defining adequate assurance, and provided extraordinary new protection to utility companies.

Debtors must now provide actual cash deposits or security instead of administrative expense priority and must either accept what the utility proposes as adequate assurance or seek an expedited hearing on adequate assurance during the first 30 days of the case. This new

subsection shifts the burden from the utility to the debtor and places the utility in a great position of power.

A *Chapter 11* debtor's attorney and staff are very busy during the first 30 days of the case, and this could be an easy issue to overlook or fail to address in a timely manner. Under the prior version of *§ 366*, all the debtor had to do was make an offer to the utility during the first 20 days of the case, then wait to see what the utility did in response. This was not burdensome to the debtor or the debtor's legal team, and could be accomplished at the last minute.

Under revised *§ 366*, the utility dictates the bargaining process and can force the debtor into an unacceptable arrangement, or force the debtor to address the issue before the court at a time when the debtor is dealing with other pressing issues. The debtor can no longer afford to wait to resolve this issue and must now take a proactive stance to resolve the issue or prepare to bring it before the court during the first 30 days of the case.

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